

15.0 DIRECT SERVICE INDUSTRY POWER RATE DEVELOPMENT

15.1 Introduction

The rates charged to BPA's DSI customers are based on section 7(c) of Northwest Power Act. 16 U.S.C. §839e(c). Section 7(c)(1)(B) provides that after July 1, 1985, the DSI rates will be set "at a level which the Administrator determines to be equitable in relation to the retail rates charged by the public body and cooperative customers to their industrial consumers in the region." 16 U.S.C. §839e(c)(1)(B). There are three specific directives associated with this provision:

1. Pursuant to section 7(c)(2), this determination is to be based on BPA's "applicable wholesale rates" to its preference customers and the "typical margins" included by those customers in their retail industrial rates.
2. Section 7(c)(2) also establishes the so-called DSI "floor rate," which requires that the DSI rates shall be no less than the rates in effect for the contract year ending June 30, 1985.
3. Section 7(c)(3) provides that the DSI rates are also to be adjusted to account for the value of power system reserves provided through contractual rights that allow BPA to restrict portions of the DSI load.

This chapter of the ROD addresses issues relating to these statutory provisions and issues that have been raised in connection with the Compromise Approach for service to the DSIs that was proposed in this proceeding.

15.2 7(c)(2) Industrial Margin

15.2.1 Revenue Taxes

BPA has performed a margin study on only two prior occasions. The margin was first calculated during the 1985 rate case. Then, in 1987, BPA established the IP-PF rate link, under which the typical margin was inflated each rate period by the Gross National Product deflator. The rate link made it unnecessary to recalculate the typical margin until 1996. 1985 ROD, WP-85-A-BPA-02, at 129-158; 1996 ROD, WP-96-A-02, at 145-189. Since the IP-PF Link has expired, BPA has once again conducted an industrial margin study and calculated new values for the typical margin for the FY 2002-2006 rate period.

As noted above, section 7(c)(1)(B) of the Northwest Power Act provides that rates for sales to DSIs must be "equitable in relation to the retail rates charged by . . . the public body and cooperative customers to their industrial consumers in the region." In order to accomplish this goal, section 7(c)(2) of the Northwest Power Act further provides that:

The determination under paragraph (1)(B) of this subsection shall be based upon the Administrator's applicable wholesale rates to such public body and

cooperative customers and the typical margins included by such public body and cooperative customers in their retail industrial rates but shall take into account:

- (A) the comparative size and character of the loads served;
- (B) the relative costs of electric capacity, energy transmission, and related delivery facilities provided and other service provisions; and
- (C) direct and indirect overhead costs, all as related to the delivery of power to industrial customers . . .

16 U.S.C. §839e(c)(2). Thus, the wholesale rate that forms the basis for the DSI rate must include a typical retail margin that takes into account the factors stated above. The purpose of the 7(c)(2) Industrial Margin Study is to calculate that margin.

PPC assisted in gathering the information used in the industrial margin study. Wholesale Power Rate Development Study, WP-02-E-BPA-05, at 118. The reason for this was that BPA was informed that the participating utilities believe public distribution of customer-specific information could cause them competitive harm. Ebberts, WP-02-E-BPA-22, at 2-3. As a condition for providing this data, the PPC required that all references identifying the utility and its industrial customer(s) be deleted from all data sources. *Id.* Thus, utility and industry identities were masked, much as was done in the 1985 margin study. *Id.* Entities wishing to review the data, including BPA, were required to sign a confidentiality agreement that limits its use and dissemination. *Id.*

Eligibility for participation in the survey was limited to utilities that have at least one industrial customer with a peak demand of at least 3.5 MW. Wholesale Power Rate Development Study, WP-02-E-BPA-05, at 117. BPA identified 35 public body and cooperative customers believed to be serving at least one industrial customer with a peak demand of at least 3.5 MW, and received 22 responses. Ebberts, WP-02-E-BPA-05, at 3-4. BPA requested that utilities provide the most recent cost of service analyses used in establishing existing industrial rates. Also requested was information from contracts for industrial service under arrangements other than traditional tariff service (*e.g.*, market based or market access pricing). *Id.* at 4.

This information was used to allocate costs in categories that were then either included or excluded from the margin. *Id.* at 5-6. Costs included in the typical margin were “those direct and indirect overhead costs that are not associated with the production, transmission, and distribution of electricity.” *Id.* at 7. The individual margins derived from this information were then weighted according to the amount of energy sold by individual utilities. The result was a typical industrial margin of 0.42 mills/kWh. Wholesale Power Rate Development Study, WP-02-E-BPA-05, at 119.

Issue

Whether BPA erred in excluding revenue taxes from the margin calculation based on the conclusion that revenue taxes are not typical.

Parties' Positions

The IOUs have raised numerous issues in support of their contention that BPA has arbitrarily excluded revenue taxes from the industrial margin. They claim that BPA correctly included utility taxes in the margin in the 1985 rate case and should adopt that practice in this case. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 29. In conjunction with their position that BPA should rely on their interpretation of the 1985 ROD, the IOUs argue that BPA's witness did not make any independent analysis regarding the issue of "whether government-owned utilities and cooperatives typically pay taxes based on gross receipts from the sale of electric power and whether such taxes should be included in the 'typical retail margin'." *Id.* at 28; *see also* PGE Brief, WP-02-B-GE-01, at 9.

The IOUs also maintain that BPA has imposed an improper test for determining whether revenue taxes are includable in the margin. *Id.* at 34. According to the IOUs, BPA's test improperly equates the word "typical" with "majority" in applying that term to the determination of what cost items are properly included in the industrial margin. *Id.* at 35. PPC also dislikes BPA's test and argues that the typicality of revenue taxes should be based on the sample eligible to participate in the margin study, not the total number of BPA customers serving industrial load. PPC Brief, WP-02-B-PP-01, at 57.

The IOUs insist further that the alleged error was compounded by BPA's reliance on the faulty premise that only the state of Washington imposes a revenue tax. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 36. In support of this argument, the IOUs cite a number of statutory provisions which are purported to prove that BPA's utility customers in Oregon and Idaho "do pay revenue taxes or other payments in lieu of taxes to governmental authorities." *Id.* at 38. Thus, even under BPA's "majority" test, the IOUs conclude that revenue taxes are typical. *Id.*

PPC makes a similar argument, asserting that perhaps as many as 29 utilities in Oregon pay franchise fees and in-lieu taxes, and claiming that BPA should have investigated the issue further based on IOU testimony that "a few telephone calls" had shown that Oregon jurisdictions charge revenue taxes. PPC Brief, WP-02-B-PP-01, at 58-59, citing Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 19.

The IOUs also state that substituting the cost of DSI delivery facilities for distribution costs understates distribution costs allocable to the margin to the extent that property and other taxes are functionalized by the utility to distribution. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-03, at 39. The IOUs also argue that market conditions have changed since the 1996 rate proceeding, and so BPA does not need to "artificially" push the DSI rate as low as possible to retain industrial load in a competitive market. *Id.* at 40. Similarly, PPC argues that "the only time that revenue taxes have been excluded from BPA's margin study was in an atypical year, 1996, when BPA was struggling to keep its DSI rates competitive and retain load." PPC Brief, WP-02-B-PP-01, at 56. PPC therefore concludes that "revenue taxes may be considered typical under normal circumstances." *Id.* Finally, the IOUs argue that BPA has ignored the intent of Congress and denied benefits to participants of the Residential Exchange by failing to add a

sufficient industrial margin to the DSI rate. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-03, at 41; *see also* PGE Brief, WP-02-B-GE-01, at 10.

Arguments made by the DSIs and Alcoa/Vanalco support excluding revenue taxes from the margin. The DSIs argue that revenue taxes are neither “typical” nor “margin.” DSI Brief, WP-02-B-DS-01, at 25. The DSIs interpret the 1985 ROD as determining that “there is a clear relationship between margin per kilowatthour and customer size.” *Id.* at 27. Thus, using a 3.5 peak MW threshold as the minimum sized load to include in the data sample is appropriate for most cost categories (*e.g.*, meter reading, billing and collections, and customer service) because it is consistent with the section 7(c)(2) requirement that the Administrator take into account the “size and character” of the loads. *Id.* However, because revenue taxes are not size related, the DSIs argue that it was appropriate to consider all BPA customers serving industrial load of any size for that cost category. The DSIs argue, as well, that the IOUs failed to introduce credible evidence into the evidentiary record to establish their claim that states other than Washington levy revenue taxes. *Id.* at 29.

In addition to arguing that revenue taxes are not typical, the DSIs argue that revenue taxes are not margin. *Id.* at 30. Obligations for remittance of taxes imposed on a utility by the taxing authority are far different, the DSIs claim, from normal costs. In such instances, the utility is simply acting as a conduit for the taxing authority’s policy choices with respect to who is taxed and how the tax is to be collected. *Id.* at 29. This fact, it is argued, “creates the anomalous result that the form of tax determines whether it is margin or not.” *Id.* Thus, to the extent that it can be concluded that revenue taxes are “typical,” they should be allocated to the four cost categories based upon the ratio of total costs assigned to each category. *Id.*

Alcoa/Vanalco make a similar argument, maintaining that Washington’s revenue tax is “collected as a fixed percentage on the total delivered cost of power.” Alcoa/Vanalco Brief, WP-02-B-AI/VN-01, at 69. Since it is not assessed uniformly across all loads, they argue that the tax should not be considered part of the typical margin. *Id.* Alcoa/Vanalco also assert that the 1.72 mills/kWh margin proposed by PPC, based on revenues actually needed to accomplish billing and customer service functions, is irrational on its face and should be replaced by a 0.34 mills/kWh margin. *Id.* at 8.

The IOUs take exception to the Administrator’s draft decisions in the Draft ROD. They disagree with the Administrator’s draft decision “regarding the Distribution component attributable to margin.” IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 31 and n. 98. They also argue once again that BPA’s treatment of revenue taxes deprives the Residential Exchange participants of benefits totaling \$8,000,000 per year over the rate period due to BPA’s failure “to acknowledge the interrelationship between the floor rate calculation and margin calculation.” *Id.* at 32. The IOUs further maintain that they have provided the only testimony on this issue. *Id.* at n. 102. The IOUs argue further that BPA has taken too narrow a view of “revenue taxes” and has not conducted a proper analysis of the issue. *Id.* at 32. Another argument repeated in the IOU brief on exceptions is that Congress intended the margin to be 25 percent to 33 percent. *Id.* at n. 105.

In its brief on exceptions, PPC re-argues the contention that the determination regarding revenue taxes should have been based on the margin sample and not the entire population of utilities serving industrial load. PPC Ex. Brief, WP-02-R-PP-01, at 13. PPC also states that in the Draft ROD, BPA did not accurately reflect PPC's position when BPA assumed that PPC considered revenue taxes to be overhead costs. *Id.*

BPA's Position

Revenue taxes are not typical and should therefore be excluded from consideration in calculating the industrial margin. Ebberts, WP-02-E-BPA-22, at 8. Washington is the only state in BPA's service territory that can reasonably be characterized as assessing a revenue tax. *Id.* at 8; Ebberts, WP-02-E-BPA-47, at 6. Thus, such taxes are not typical with respect to the PNW region that BPA serves, and they are not typical with respect to the relevant BPA customer base serving industrial load within that region. Ebberts, WP-02-E-BPA-22, at 8; and Ebberts, WP-02-E-BPA-47, at 6.

Evaluation of Positions

BPA's analysis of whether revenue taxes should be included in the margin considered both: (1) the number of utilities serving industrial load and subject to a revenue tax; and (2) the number of states within BPA's service territory which levy a revenue tax. Ebberts, WP-02-E-BPA-47, at 6. Based on those parameters, BPA concluded that, for purposes of calculating the industrial margin, only the state of Washington levies a gross revenue tax. *Id.* This means that revenue taxes are typical neither of the states within BPA's service territory nor among BPA's customers serving industrial load. *Id.* Therefore, revenue taxes are not "typical" as contemplated by section 7(c)(2) of the Northwest Power Act and should be excluded from the margin. *Id.*

The IOUs and PPC have challenged this finding and presented numerous arguments attempting to show that revenue taxes are, in fact, typical. PPC concludes that they should be assigned to the "Other" category, with the result that they would be included, in their entirety, in the margin. PPC Brief, WP-02-B-PP-01, at 60. In the Draft ROD, BPA inferred that PPC intended that revenue taxes be treated as direct or indirect overhead, which would achieve that result. BPA felt that this step was necessary to complete PPC's argument, because once an item is considered typical for purposes of the margin calculation, a determination must be made regarding how that item should be allocated across the various categories. PPC's brief on exceptions, however, takes issue with BPA's characterization of that aspect of its position. PPC Ex. Brief, WP-02-R-PP-01, at 14. Consequently, BPA defers to PPC's desire not to adopt such a position.

The IOUs argue that the two-part test employed by BPA, as described above, is improper because it is a new standard, uniquely applied to revenue taxes in contradiction of the methodology used in 1985. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-03, at 34. While BPA is not bound by the 1985 ROD, its actions in this instance are not in any way inconsistent with the principles guiding the Administrator in that case. There, the DSIs had argued, in part, that "revenue taxes should be excluded because they are not paid in all jurisdictions." WP-85-A-BPA-02, at 137. The Administrator found this argument unpersuasive: "The fact that

not all utilities incur revenue taxes is no more a basis for a blanket exclusion from the margin than would be the exclusion of any other cost not incurred by each and every public agency in the region.” *Id.* at 138. The Administrator’s finding in 1985, then, responded to the very two criteria that BPA has adopted in this case: the number of jurisdictions levying revenue taxes and the number of public agency customers subject to such taxes.

The Administrator concluded in 1985 only that the “record fails to provide a compelling reason for not considering revenue taxes as a cost of doing business.” *Id.* at 139. Thus, the potential for reconsideration based on different arguments, or a more complete record, was clearly a possibility. In 1996, the Administrator found that a more complete record had been developed, one that focused on which states levied revenue taxes and which of those states had public agency customers serving industrial load. 1996 ROD, WP-96-A-02, at 178. Based in part on this rationale, revenue taxes were excluded from the margin calculation. Thus, the issue of whether revenue taxes should be included in the industrial margin was addressed in both 1985 and 1996, the only two occasions when a margin calculation was necessary. 1985 ROD, at 129-158; 1996 ROD, at 145-189.

BPA’s witness reviewed materials from both the 1985 and 1996 rate cases. Tr. 1734, 1835. This review was prompted by the witness’s belief that, in preparing his testimony, “[i]t was important to know the whole history of the typical margin.” Tr. 1835. As a result of this review, the witness determined that it was appropriate to rely upon the methodology more closely represented by 1996. Tr. 1747, 1835. This conclusion was based on the witness’s professional assessment that the 1996 methodology “is a correct way to do it.” Tr. 1750. The methodology, then, is not entirely new. It is simply a refinement of principles that have been used in this arena on the only two prior occasions when a typical industrial margin has been calculated.

To the extent that any features of this methodology apply uniquely to revenue taxes, that treatment is appropriate given the difference between taxes and most of the other cost items taken into account in calculating the margin. For example, the margin sample itself is limited to utilities that serve a peak industrial load of 3.5 MW or greater. In keeping with the statutory requirement to consider the “comparative size and character of the loads served,” the 3.5 MW limitation attempts to account for any economies of scale realized in the retail rates of larger industrial loads with respect to routinely incurred costs reported in the sample. Taxes, by contrast, are not costs incurred by a utility, but costs imposed by governmental bodies making policy choices. The Joint DSIs make this point in testimony describing the Washington revenue tax:

Revenue taxes are not a cost of doing business, rather a consequence of a utility doing business in Washington. The State of Washington has chosen to collect its taxes in a number of ways, a primary source being retail sales taxes. Rather than charge the sales tax on electricity, the state imposes a revenue tax on the utilities. The utilities are collecting these taxes through their billings, but the money collected does not truly belong to the utility. The utility has no real discretion in determining how these funds will be used. They must remit all collections to the state. Therefore, just as sales taxes are not part of a retail seller’s margin, revenue taxes are not a part of a utility’s margin.

Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 7. While the Joint DSIs are arguing that revenue taxes are not margin, the description also bears on why taxes should be treated differently than routine costs associated with the business of electric utilities. Because taxes are imposed by taxing authorities for policy reasons, there is no basis to initially assume any economic relationship between taxes imposed and the size of the load. Therefore, the basis for a 3.5 MW threshold is not necessarily applicable. Moreover, the limitations of the margin sample with respect to the revenue tax issue are compounded by the fact that participation is voluntary. As the DSIs correctly note: “. . . by making the typicality determination based on the whole population, as BPA did both in 1996 and in this case, BPA eliminated the concern that the self-selection process could bias the results on this issue.” DSI Brief, WP-02-B-DS-01, at 28. Self-selection is a greater concern for this issue because of the lack of uniformity across jurisdictions on taxation, a problem not present for routine costs that are unaffected by political boundaries.

Thus, there are sound reasons for treating revenue taxes independently from the margin sample, and the Administrator is not persuaded by PPC’s reiteration of its position in its brief on exceptions. PPC Ex. Brief, WP-02-R-PP-01, at 13. Moreover, the test used by BPA appropriately focuses on factors emphasized in the two previous margin determinations, *i.e.*, the number of jurisdictions that impose revenue taxes and the number of preference customers who are subject to such taxes.

In addition to arguing that BPA’s methodology is flawed, the IOUs assert that BPA’s application of its own methodology is equally flawed and therefore achieves an incorrect result. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 34. The argument is twofold: (1) BPA has improperly defined “typical” to mean “majority”; and (2) BPA has erroneously concluded that Washington is the only state that imposes revenue taxes. Neither argument has merit.

With respect to the first issue, BPA’s witness did not specifically define “typical” to mean “majority” as suggested by the IOUs. Instead, he concluded that: (1) only Washington imposes a revenue tax; and (2) most of BPA’s public agency customers with industrial load are located outside of Washington. Ebberts, WP-02-E-BPA-22, at 8; Ebberts, WP-02-E-BPA-47, at 6. BPA’s witness testified that he defined “typical” as meaning “serving as a characteristic example” or being “representative of a whole group.” Tr. 1869, 1870. He also indicated they he did not believe that “a very small minority would represent typical” and stated that, in this instance, he did apply a “majority rule” in the case of revenue taxes. *Id.*

This approach, in general, is consistent with the approach taken in 1996:

If a given trait is peculiar only to a minority of a population, it cannot be said to be either ‘representative of the whole group’ or ‘a characteristic example.’ If anything the opposite is the case: the absence of the trait is representative and characteristic. Therefore, if only a minority of utilities include revenue taxes in their margins, then such taxes are not a component of the typical industrial margin.

1996 ROD, WP-96-A-02, at 178.

While not required to do so, BPA finds this approach reasonable and has adopted it in this case. Applying this standard, revenue taxes should certainly be excluded from the margin calculation if only a minority of the states in BPA's service territory impose revenue taxes and only a minority of BPA customers pay revenue taxes. It is not necessary to determine whether a bare majority would be sufficient to make a cost typical.

PPC and the IOUs also argue that, even applying such a rule, BPA's determination is incorrect because, they claim, the States of Oregon and Idaho impose gross revenue taxes, and many local government units in Oregon require electric utilities to pay franchise fees. However, while some of the referenced taxes are based on revenues, it is not proper to characterize them as revenue taxes. BPA has made it clear in 1985, 1996, and again now that the state of Washington imposes a revenue tax. The relevant statutory provision is Chapter 82.16 of the Revised Code of Washington, which describes the "Public Utility Tax" and provides as follows:

There is levied and there shall be collected from every person a tax for the act or privilege of engaging within this state in any one or more of the businesses herein mentioned. The tax shall be equal to the gross income of the business, multiplied by the rate set out after the business, as follows:

(1) Railroad, express, railroad car, water distribution, light and power, telephone and telegraph businesses: Three and six-tenths percent;

R.C.W. 82.16.020.

The statute defines "light and power business" as the "business of operating a plant or system for the generation, production or distribution of electrical energy for hire or sale."

R.C.W. 82.16.010(5). "Gross income" is defined as the "value proceeding or accruing from the performance of the particular public service or transportation business involved, including operations incidental thereto, but without any deduction on account of the cost of the commodity furnished or sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses." R.C.W. 82.16.010(13).

The definition of "gross income" has been held to include state and city privilege taxes collected by a PUD supplier of electricity, even though customers of a district were billed for privilege taxes as a separate item and the receipts were remitted separately and directly to the taxing authority. *Public Utility Dist. No. 3 of Mason County v. State*, 427 P.2d 713 (1967). It has also been held that the Washington tax is not a license tax serving as a prerequisite to entering into business or promoting a regulatory purpose; rather, it is imposed solely for revenue purposes. *Columbia River Bridge Co. v. State*, 282 P.2d 283 (1955). Similarly, a tax imposed by ordinance of the City of Seattle was determined to be a license or occupation tax and not a tax imposed on the sale or distribution of property or a service. *Seattle Gas Co. v. City of Seattle*, 73 P.2d 1312 (1937).

The essential features of the Washington revenue tax, then, can be described as follows: (1) it is a comprehensive tax, imposed solely for revenue purposes; (2) it is levied and administered at the state jurisdictional level; (3) it is a tax on “gross income,” defined broadly; and (4) it is not a license fee, regulatory tax, or occupation tax.

The question then becomes whether such taxes are, for purposes of calculating the industrial margin, typical of the BPA service territory and typical of the Administrator’s customer base serving industrial load. The answer is no. For example, the IOUs offer ORS §308.805 and §308.807 as an example of a revenue tax paid by cooperative utilities in the State of Oregon. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 37. The statute provides as follows:

(1) Every association of persons, wholly mutual or cooperative in character, whether incorporated or unincorporated, the principal business of which is the construction, maintenance and operation of an electric transmission and distribution system for the benefit of the members of such association without intent to product profit in money and which has no other principal business or purpose shall, in lieu of all other taxes on the transmission and distribution lines, pay a tax on all gross revenue derived from the use or operation of transmission and distribution lines (exclusive of revenues from the leasing of lines to governmental agencies) at the rates prescribed by ORS 308.807. The tax shall not apply to or be in lieu of ad valorem taxation on any property, real or personal, which is not part of the transmission and distribution lines of such association.

ORS §308.807(1).

The taxed entity may elect to base the amount of tax owing to the lesser of 4 percent of gross revenue from “use or operation of transmission and distribution lines minus the cost of power” or an alternative formula based on the “market value” of the transmission and distribution lines. ORS §308.807(2). The taxes are distributed to the relevant county governments and apportioned to the county school fund and general fund. ORS §308.815.

The Oregon tax is not analogous to the Washington revenue tax in any fundamental or meaningful way. First, it is not a revenue tax at all, but rather a property tax. As the Supreme Court of Oregon has held:

ORS chapter 308 deals with valuation of various types of property for property tax purposes. ORS 308.805 through 308.820 deal with a specific type of property (electrical distribution systems) owned by a specific class of taxpayers (non-profit electric cooperatives). ORS 308.805 provides a method of taxing such property different from the usual ad valorem method based on assessed value. Although the tax is measured by gross revenue, the tax is more properly considered a property tax than an income tax.

Lane Electric Cooperative v. Department of Revenue, 765 P.2d 1237, 1239 (1988).

While the holding of the Oregon Supreme Court is not binding on the Administrator for purposes of interpreting section 7(c)(2), the description clearly comports with the statutory language, and the Administrator finds it persuasive with regard to the character of the tax. Moreover, the court's interpretation is supported by the fact that the income basis for the tax applies only if the tax owed is less than the tax would be if based on the market value of the property itself. Thus, the tax embodied in ORS chapter 308 is not a revenue tax, but a property tax.

Moreover, the Oregon tax differs in other material respects from the tax imposed by the state of Washington. First, it is not a comprehensive tax at the state level; instead, it is specifically targeted at a very limited classification of taxpayers and is earmarked for use by the county for specific purposes. Second, because the funds are distributed to the county governments, the tax is not wholly administered at the state level. Third, even if it could be characterized as an income tax, the Oregon tax is not a tax on "gross income," but a tax on income derived from a specific and limited type of property. For purposes of calculating the margin, two taxes of a completely different character cannot simply be lumped together and treated as though they are the same thing.

The IOUs' reliance on Idaho's statute, IC 63-3502, is similarly misplaced. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 38. That tax applies to any "Cooperative Electrical Association," defined as "any nonprofit, cooperative association organized and maintained by its members, whether incorporated or unincorporated, for the purpose of transmitting, distributing or delivering electric power to its members." IC 63-3501. The tax is computed at a rate of 3.5 percent on gross earnings after deducting that figure by its costs of power and certain Energy Northwest costs. IC 63-35-02. Moreover, payment of the tax is deemed to be in lieu of all other property taxes. Thus, it is very similar to the Oregon tax and for the same reasons, it is a property tax rather than a revenue tax. As the DSIs correctly note:

Many of the utilities that assess taxes that might be called 'revenue taxes' in reality collect taxes *in lieu* of property taxes. Property taxes are appropriately assigned to the production, transmission, and distribution categories in the margin study, depending upon the taxable property upon which they are levied. These *in lieu* taxes are not revenue taxes of the kind that is levied by utilities located in the State of Washington.

DSI Brief, WP-02-B-DS-01, at 30.

Therefore, it is incorrect for PPC and the IOUs to conclude that these tax statutes should be characterized as revenue taxes.

The IOUs also cite franchise fees authorized under ORS §221.420 and §225.270. Again, such taxes are not revenue taxes. ORS §221.420 is a statute that, primarily, broadly sets forth the regulatory authority of municipalities with respect to public utilities, including ratesetting authority and the authority to order construction and modification of physical equipment. One part of this statute permits the imposition of fees and establishment of terms and conditions whereby a utility "may be permitted to occupy the streets, highways or other public property within such city." Thus, the statute does not authorize the municipalities to charge a revenue tax.

The statute gives municipalities the authority to regulate the conduct of utility business within the municipal limits and to charge an “occupation fee” that may be based on gross revenues. As indicated above, the Washington courts have held that the Washington revenue tax is not a tax of this type. And for good reason: such taxes are not comprehensive, they are administered locally, and they are basically “occupation” taxes that serve regulatory purposes. The IOUs’ reasoning with respect to franchise fees levied pursuant to IC 50-329 and 50-329 is flawed for essentially the same reasons. Thus, they are not analogous to the tax levied by the State of Washington in any material respect and they cannot accurately be characterized as revenue taxes.

As for ORS §225.270, that statute authorizes municipally owned utilities to assess 3 percent of annual gross operating revenue derived from electric powerplants or systems or distribution systems “for the purpose of reducing general property taxes within such city.” Again, simply because the tax is based on a percentage of revenues, it does not necessarily follow that the tax is a revenue tax. In this instance, the legislature made a policy choice to require that certain revenues be used to benefit a particular class of taxpayers, *i.e.*, those who pay property taxes within the city limits. Such a tax scheme is not comprehensive, nor is it imposed for revenue purposes.

In conclusion, the legal analysis shows that BPA’s witness was correct in stating that only the state of Washington levies a revenue tax for purposes of considering whether such taxes are includable in the industrial margin. Ebberts, WP-02-E-BPA, at 8; Ebberts, WP-02-E-BPA-47, at 6. Parties such as the IOUs and PPC have complained repeatedly that no independent judgment was exercised and, as a result, there is no factual basis for such a conclusion. *See, e.g.*, IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 28. Such contentions are without merit. BPA’s witness exercised independent judgment in determining what test should be used to determine whether revenue taxes should be included in the margin. As the BPA witness repeatedly testified, he did not use the 1996 ROD as precedent. To the extent he relied on the 1996 ROD, it was because, in his independent professional judgment, it provided the correct guidance. Tr. 1750.

With respect to the factual basis for the conclusion reached, BPA has consistently maintained that no factual evidence is required to reach the conclusion that only Washington levies revenue taxes. The answer to that question, as illustrated above, can be derived independently through the exercise of reasoning applied to nothing other than authorities commonly used in legal analysis. It would have been inappropriate under the procedural rules to make such materials a part of the factual record, or to require the witness to testify to legal issues. *See Rules of Practice to Govern These Proceedings*, WP-02-O-01, at 5.

The IOUs contend that BPA takes a view of revenue taxes that is too narrow, arguing that the Draft ROD “concludes that only Washington levies revenue taxes because a tax is a revenue tax only if it is just like the taxes levied in Washington.” IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 32. Such a statement ignores the analysis and conclusions from the Draft ROD. The Administrator concluded in 1985, 1996, and again here that Washington levies a revenue tax. The simple fact is that the other taxes proposed by the IOUs for inclusion in the margin are not revenue taxes. As is abundantly clear from the discussion above, this conclusion was derived at three levels: primary statutory interpretation,

examination of relevant case law, and comparison with the Washington statute. All three levels of analysis lead to the same conclusion. Nowhere does BPA state that a tax has to be “just like” the Washington tax in order to be a revenue tax, but it does have to be a revenue tax.

Because BPA’s conclusion regarding which jurisdictions levy revenue taxes is correct, it follows that the only factual determination necessary is whether, at a minimum, a majority of the Administrator’s public agency customers serving industrial load are subject to Washington’s revenue tax. BPA’s witness provided this information in direct testimony and furnished updated numbers in rebuttal, concluding that 32 utilities serving industrial load are in Washington, and 51 are located elsewhere. Ebberts, WP-02-E-BPA-22, at 8; Ebberts, WP-02-E-BPA-47, at 7.

The evidence provided by BPA was not refuted by any party. While making numerous arguments regarding the proper application of the statutory directives and such matters as whether to use the margin sample or the general population, no one supplemented the factual record or offered any convincing rebuttal to BPA’s evidence. PPC was content to rely upon “BPA’s direct case and historical evidence in [its] testimony.” Hansen *et al.*, WP-02-E-PP-06, at 25. The IOUs argued about the meaning of “equitable” and asserted only that “[w]ith a few telephone calls, we identified several jurisdictions in Oregon that levy revenue taxes on public utilities and cooperatives.” Hoff *et al.*, WP-02-E-AC/GE/IP/MP/PL/PS-03, at 19. In rebuttal, BPA’s witness noted that such unsubstantiated anecdotal evidence was not a sufficient basis for reaching the conclusion that jurisdictions other than Washington levy revenue taxes. Ebberts, WP-02-E-BPA-47, at 6. On brief, PPC makes the following observation with respect to the IOU testimony:

The parties’ evidence may have been insufficient to establish a foundation for a margin study or to conclude that a majority of regional utilities, as the witness defined “typical”, with any industrial customers are charged revenue taxes. However, it is without question sufficient information to warrant further investigation by BPA into the existence of revenue taxes outside of Washington. No such investigation occurred.

PPC Brief, WP-02-B-PP-01, at 59.

Notably, no support is cited for the conclusion that BPA is under an obligation to conduct such an investigation. Indeed, it would be hard to imagine how a rate proceeding could ever end if, when confronted by evidence “insufficient” to support a party’s conclusion, BPA were under an affirmative duty to conduct an “investigation” to ascertain whether other “sufficient” evidence, not presented by the party, can be found. PPC’s logic is untenable. The uncontradicted evidence on the record is sufficient to reach the conclusion that revenue taxes are not typical for the purpose of calculating the industrial margin.

The IOUs also argue that BPA’s margin calculation is not in keeping with actual margin levels or the intent of Congress. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 41. With respect to the first point, the IOUs rely on a document for which they requested official notice. That request has been denied. *See* ROD chapter 18. Thus, there is no evidence on the record to support the IOUs’ contention. Moreover, BPA does not believe that such information would be

particularly relevant or helpful to determining the acceptable range for the section 7(c)(2) industrial margin calculation. As BPA's witness noted: "... [T]he typical industrial margin is not the same thing as what you may find to be a margin in retail rate making. This thing that I am doing is an artifact of the Act; no other utilities do this. . . ." Tr. 2009.

As to the intent of Congress when it enacted this provision, the IOU position is equally unpersuasive. The IOUs make no attempt to show any relationship between the industrial margin and the cited exhibit, which is described as showing a "prototypical rate case with typical margins of 25 and 33 percent of the applicable wholesale power costs." IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 43. As noted in BPA's testimony, cited above, and as is clear from the statutory language, the typical industrial margin was a creation of the Act itself. It was not to be equated with actual margins. This is made plain by the statutory language that refers to "typical margins" and then requires the Administrator to take into account:

- (A) the comparative size and character of the loads served;
- (B) the relative costs of electric capacity, energy transmission, and related delivery facilities provided and other service provisions; and
- (C) direct and indirect overhead costs, all as related to the delivery of power to industrial customers

16 U.S.C. §839e(c)(2). The statute creates a ratemaking directive that must be interpreted and applied in a manner that comports with all of BPA's ratemaking requirements and statutory responsibilities. References to "prototypical" margins are of little assistance either in divining the Congressional intent or applying those standards properly.

Finally, PGE and the IOUs argue that BPA's treatment of revenue taxes unreasonably deprives the Residential Exchange participants of statutory benefits. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 39; PGE Brief, WP-02-B-GE-01, at 10. PGE poses the argument as follows:

If the industrial margin is set artificially low by excluding costs of taxes that properly should be included, the IP rate will be set artificially low. Setting an artificially low IP rate results in a higher PF Exchange rate, and decreases Residential Exchange benefits. This result is inconsistent with the goal of providing an equitable share of FCRPS benefits to investor-owned utilities' residential and small farm customers. Including revenue taxes in the margin will result in an increase in the value of Residential Exchange benefits of \$8,322,000 per year.

PGE Brief, WP-02-B-GE-01, at 10.

In the Draft ROD, BPA maintained that it is unlikely that allocating the entire amount of revenue taxes to the margin would result in any change in the rates charged to the DSIs. Based on PPC's adjustment to the margin of 1.18 mills/kWh if revenue taxes are included, Hansen *et al.*, WP-02-E-PP-06, at 29, BPA concluded that the resulting IP rate would still be less than the floor

rate. Thus, there would be no change in the PF Exchange rate and no detriment to Residential Exchange participants. Draft ROD, WP-02-A-01, at 15-13.

The IOUs take issue with this conclusion. IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 32. They do not demonstrate the analytical basis for their calculation. Nor do they show how the alleged “interrelationship between the floor rate calculation and margin calculation” negates BPA’s conclusion. However, it is not necessary to determine whether BPA or the IOUs is correct. Speculation about different outcomes for the Residential Exchange program depending on treatment of revenue taxes is relevant primarily for assessing how important it is to decide the issue at this time. For that purpose, BPA accepts that there is significant disagreement as to potential effects on the Residential Exchange.

It should also be noted, however, that even if revenue taxes were deemed “typical,” it does not necessarily follow that the entire amount would be included in the margin. The Joint DSIs, for example, argue that it would not be unreasonable to allocate such costs across the spectrum of cost categories to the extent that each category contributes to the amount of revenue tax incurred:

If it were determined that revenue taxes were both “typical” and “margin”, only a small portion of the taxes should be included in the Industrial Margin. Revenue taxes are assessed as a percentage of the sales price of the electricity. The sales price reflects four cost components: production, transmission, distribution, and “other overhead costs”. Therefore, the contribution of each of the components to the sales price is incurring the same percentage in contributing to the amount of revenue taxes collected. Therefore, if a utility’s revenue tax was a particular percentage of the total bill, and since the total bill is determined by each of the components, the revenue tax can be assigned to each of the components based on costs causation.

Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06, at 9.

The IOUs suggest that such an outcome would understate the margin with respect to distribution costs, because BPA uses DSI delivery facility charges as a surrogate for distribution costs. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 39. The IOUs cite nothing in the record to support their conclusion. Moreover, the argument ignores issues that could arise in collecting information necessary to calculate the level of taxes that might reasonably be included in the distribution component attributable to the margin.

In response to the concern expressed by the IOUs that BPA has not delineated these issues, IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 32; BPA’s witness noted at cross examination the economies of scale associated with large industrial consumers, Tr. 1851. Such factors make it likely that a much smaller cost for distribution facilities would be associated with large industrial customers than would be the case for high density residential load. This would also mean that large industrials would bear a smaller portion of the tax liability associated with such property. Making this determination accurately, however, would require more data than has been solicited in any margin study to date. Moreover, with respect to the franchise fees promoted by the IOUs for inclusion in the margin, those generally attach solely to business

conducted within specifically defined municipal boundaries. It is not at all clear large industrials are located within such boundaries. Again, this is a type of information that has never been solicited in a margin study. In sum, the Administrator believes that substitution of DSI delivery facilities for distribution costs would remain a reasonable approach to this issue even if revenue taxes were included in the margin and allocated across the spectrum of cost categories.

To summarize the most pertinent findings, BPA concludes that:

- (1) revenue taxes are not typical for purposes of calculating the industrial margin and should be excluded; and
- (2) even if revenue taxes were deemed typical, it cannot be concluded that they should necessarily be allocated in their entirety to the margin; and

Decision

Washington is the only state in BPA's public agency service territory that levies a revenue tax. Because only one state levies such a tax and because less than a majority of preference customers are located in that state, it is reasonable to conclude that revenue taxes cannot be considered part of a "typical" industrial margin.

15.2.2 Margin Sample

Issue 1

Whether BPA erred in treating data from Utilities No. 9 and No. 31 differently, where one reflected the reported difference between the costs allocated to the industrial class and the other reflected revenues that the rates to that class will produce.

Parties' Positions

The DSIs argue that the cost of service analyses for Utilities No. 9 and No. 31 showed differences between the costs allocated to industrial customers and the revenues expected to be collected from those customers. The DSIs maintain that BPA erred by treating the two amounts differently. DSI Brief, WP-02-B-DS-01, at 24. The DSIs reiterate their earlier arguments in their brief on exceptions and note that the "Draft ROD's statement that the \$40,000 revenue shortfall was associated in the cost of service analysis documentation of utility No. 9 with certain interest and other income is not support by the citation provided and is not supported by any evidence in the record." DSI Ex. Brief, WP-02-R-DS-01, at 9.

BPA's Position

BPA asserts that different treatment of costs apportioned to the margin category is appropriate due to factual differences reflected in the information reported by Utilities No. 9 and No. 31. Ebberts, WP-02-E-BPA-47, at 11. In connection with this issue, the Draft ROD made the following statement: "More specifically, this utility identified \$60,000 from interest and other

income in its cost of service analysis documentation that would be used to meet expected costs. Of this, \$20,000 was functionalized to the capital expenditures category.” Draft ROD, WP-02-A-01, at 15-15. As indicated in the statement itself, and as noted in the DSI brief on exceptions, this breakdown of costs does not appear in the WPRDS or in testimony. Instead, it comes from the underlying documentation. The DSIs are, therefore, correct that the information is not on the record, and the statement should, therefore, be redacted from the evaluation. This does not, however, change the professional judgment of BPA’s witness to the effect that the information was sufficiently reliable to be included in the study and should be treated as a revenue credit. Ebberts, WP-02-E-BPA-10, at 9-11.

Evaluation of Positions

The DSIs note that Utility No. 31 reported, for its industrial customer class, anticipated revenues exceeding allocated costs by \$240,000. DSI Brief, WP-02-B-DS-01, at 24. They point out that, consistent with prior practice, BPA assigned this “rate margin” to the “other” category for inclusion in the typical margin. *Id.* The DSIs go on to say Utility No. 9 reported, for its industrial class, anticipated revenues \$40,000 less than the allocated costs, but BPA did not assign this negative rate margin to “other.” *Id.* Instead, BPA apportioned the shortfall to production, transmission, distribution, and other. Ebberts, WP-02-E-BPA-47, at 11. The DSIs state that the practical effect was to overstate the margin attributable to this utility by inappropriately treating the negative margin as a revenue credit and spreading the amount across cost categories that are not included in the margin calculation. DSI Brief, WP-02-B-DS-01, at 24. They assert that, in fact, the utility had no identified revenue credit, just rates less than the allocated costs. *Id.* Such a shortfall, the DSIs argue, is no different than the positive rate margin for Utility No. 31, and it should be treated the same, *i.e.*, assigned to other. *Id.* The DSIs maintain that in prior margin studies, both positive and negative rate margins have been assigned to “other.” *Id.*

BPA does agree that, in the case of Utility No. 31, the cost of service analysis showed a markup over expected costs of \$240,000, which was properly assigned to the margin. Ebberts, WP-02-E-BPA-47, at 11. BPA disagrees, however, with the DSIs’ claim that Utility No. 9 reported no identified revenue credit. In fact, the data reported by Utility No. 9 reflected a revenue source of \$40,000 that would be used to balance expected costs with expected revenues. Ebberts, WP-02-E-BPA-47, at 11. BPA does not consider this amount to be a “negative” margin below expected costs, but rather a source of income that would be used to meet some part of the various categories of expected costs. Therefore, it was apportioned “based on relative shares of revenue requirement” consistent with the methodology adopted in BPA’s initial proposal. Ebberts, WP-02-E-BPA-22, at 6.

Thus, BPA was correct in considering this amount a revenue credit rather than margin. *Id.* BPA established in its direct testimony that such income credits (if not functionalized already by the utility to a production, transmission, or distribution category) would be apportioned to the various cost categories based on relative shares of revenue requirements. Ebberts, WP-02-E-BPA-22, at 6. BPA’s treatment of Utility No. 9 is consistent with the treatment of all other utilities that identified an income credit and did not specifically functionalize this income

credit to cost items that would be apportioned to the production, transmission, distribution, or other category. *Id.*

Decision

BPA did not err in its treatment of Utilities No. 9 and No. 31. The treatment of cost of service analysis data from these two utilities is consistent with established methods identified in BPA's direct testimony. To the extent that the data for the two utilities were characterized differently as margin on the one hand and a revenue credit on the other, that conclusion reflects a reasonable assessment of two different factual situations.

Issue 2

Whether Utilities No. 5 and No. 14 should be excluded from the margin sample because they provided data that were not in the form of independently verifiable business records.

Parties' Positions

The DSIs argue that the preference utilities providing the margin data would benefit from somewhat lower rates if the margin were larger. DSI Brief, WP-02-B-DS-01, at 22-23. While the DSIs do not maintain that this fact necessarily indicates bias in the data supplied, they argue that, under such circumstances, the data supplied by utilities should be verifiable. *Id.* Materials such as cost of service analyses and financial statements are used for many business purposes, and the DSIs believe margin data should be limited to such "business records." *Id.* The DSIs conclude that, because Utilities No. 5 and No. 14 were not required to submit such independently verifiable documentation, they should be excluded from the margin sample. *Id.*

Finally, they argue that the information should be excluded because it consists of unsworn statements that do not fall within any exception to the hearsay rule. *Id.* at 23. In their brief on exceptions, the DSIs argue, without citing any support, that BPA's determination that the DSIs waived this argument by failing to move to strike the unverifiable data is contrary to law. DSI Ex. Brief, WP-02-R-DS-01, at 9. The DSIs state that they were "arguing that BPA should give no weight to the evidence, not that it must be struck from the record as violative of some rule of evidence." *Id.* at 10.

PPC argues that both of these utilities had industrial customers on special contracts. Hansen *et al.*, WP-02-E-PP-09, at 36. According to PPC, it is entirely reasonable that they would be reluctant to provide these contracts even under the protection of a confidentiality agreement, given the increasingly competitive nature of the industry. *Id.* PPC points out that the DSIs are incorrect in asserting that a single page of information was the only data provided. *Id.* In addition to initial submittals of information, both utilities were receptive to followup telephone calls clarifying and expanding upon their earlier responses. *Id.* This additional information has also been available to parties willing to sign the confidentiality agreement. *Id.*

BPA's Position

BPA maintains that it was proper to include Utilities No. 5 and No. 14 in the sample. The two utilities confirmed that they understood what costs were to be included and how these costs would be identified in a cost of service analysis had one been available. These independent confirmations were sufficiently reliable to conclude that the data should be included in the sample. Ebberts, WP-02-E-BPA-47, at 10.

Evaluation of Positions

The Joint DSIs argue that Utilities No. 5 and No. 14 did not provide a cost of service analysis or any other reasonable documentation of the “margin” costs they submitted. Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01, at 14-15. Instead, these utilities simply asserted in response to PPCs original request for data that their margin was a certain number. *Id.* The Joint DSIs insist that such assertions are not credible in light of BPA's own recognition that

[T]he ‘industrial margin’ is a term of art employed in section 7(c)(2) of the Northwest Power Act. Although to some extent the industrial margin is intended to mimic the margins that BPA's preference customers add to their retail industrial rates, it is not a calculation the utilities themselves do. It is not an aspect of utility ratemaking.

Id., quoting 1996 ROD, at 153.

Therefore, the Joint DSIs suggest that BPA has inappropriately permitted these two utilities to make their own margin determination.

Contrary to these assertions, BPA did not ask the utilities to do their own margin calculation. BPA asked only that these utilities identify costs that would not be considered costs associated with production, transmission, or distribution, which is the same type of information BPA has relied upon in previous margin studies. Ebberts, WP-02-E-BPA-47, at 10-11.

BPA is required by section 7(c)(2) to perform sufficient analysis to develop the industrial margin calculation. However, utilities cannot be compelled to provide the information needed for the analysis. In fact, utilities have grown increasingly reluctant to cooperate in providing utility and industry data to BPA for industrial margin studies. Ebberts, WP-02-E-BPA-22, at 2. Utilities have valid concerns about publicly displaying customer specific information of such a sensitive nature, particularly given the development of an increasingly competitive power market. *Id.* In this instance, BPA could obtain the information only by signing a confidentiality agreement, which was required of all parties who wanted access to the data. *Id.* at 3. Of course, confidentiality agreements are not uncommon in the ratemaking setting, and BPA would have been hard pressed to acquire equally substantial information without agreeing to such an arrangement.

Compounding the problem of the utilities' reluctance to provide information is the relatively small population from which meaningful data can be collected. In this rate case BPA identified

only 35 utilities with industrial loads large enough to qualify, even though the 3.5 MW threshold is only a fraction of the size of the typical DSI load. *Id.* BPA requested data from all 35 and received from 22 utilities responses that were considered useable. *Id.* at 4. Given these difficulties, it would be unrealistic to require a statistically directed random sampling of qualifying utilities for purposes of collecting data for the Industrial Margin studies. Instead, BPA tries to work cooperatively with utilities so that they will voluntarily provide as much information as possible for use in the margin study.

In this case, BPA knew prior to conducting the survey that there had been a significant increase in the number of utilities and industries that have entered into nontraditional contracts. Ebberts, WP-02-E-BPA-47, at 9. It was also obvious that the costs of providing service for such arrangements might not be reflected in a cost of service analysis. Therefore, in addition to the standard cost of service analysis, BPA also requested information about these special types of contracts. *Id.* When Utilities No. 5 and No. 14 indicated that they each had a nontraditional contract not reflected in a cost of service analysis, it was reasonable to attempt to verify the nature of the information so that it could be used if possible. *Id.* at 10.

In each instance, BPA requested PPC to verify that the margin number provided represented the cost of serving the two industrial customers over and above the cost of power, transmission, and distribution. *Id.* As PPC points out, both utilities participated in followup telephone calls, clarifying and expanding upon the written information they provided. Hansen *et al.*, WP-02-E-PP-09, at 36. BPA did not rely solely on the PPCs framing of the questions for clarification. Tr. 1896. Instead, BPA provided the PPC with the types of questions to ask. *Id.* Based on the questions asked and the responses received, BPA decided that the information should be included in the Industrial Margin study.

Utility No. 5 confirmed that it had provided the same number that would have been calculated from a cost of service analysis had a cost of service analysis been provided. Ebberts, WP-02-BPA-E-47, at 10. In other words, had a cost of service analysis been provided, BPA would have accepted the utility's functionalization and allocation method and excluded from the margin calculation costs related to production, transmission, and distribution. *Id.* Utility No. 14 also indicated that it did not have a cost of service analysis for its single industrial customer, which was receiving service under a special contract. *Id.* The utility confirmed that it was serving the customer at a cost that would have been entirely assigned to either production, transmission, or distribution had a cost of service analysis been available. *Id.* In other words, there would have been no costs assigned to any "other" category, with the result that a margin of 0 mills/kWh was applied to this utility. *Id.* at 11. Of course, there would be no basis to question the reliability of a utility that was reporting no margin in light of the utility's self-interest, as identified by the DSIs, in reporting a higher margin.

Thus, BPA had every reason to have confidence regarding one utility's report and ample assurance that the other was not overstating its margin. Given these circumstances, the information is sufficiently reliable to be included when balanced against the alternative of working with a smaller, and less representative, data base.

In the Draft ROD, the Administrator stated that the evidentiary arguments were not raised at the appropriate time by motion and were therefore waived. Draft ROD, section 1.1.3. In their brief on exceptions, the DSIs claim that they were not arguing that the evidence should be stricken, only that it should be given no weight. This position is unconvincing in light of the language in the DSI initial brief:

The information regarding these utilities *does not constitute evidence*. . . . *BPA should exclude both utility No. 5 and No. 14 from the margin sample* to be consistent with BPA's prior wise practice of requiring the margin to be based on verifiable information.

DSI Brief, WP-02-B-DS-01, at 23 (emphasis added). Arguing that information does not constitute evidence and should therefore be excluded is a far cry from explaining why a piece of evidence should not be given significant weight. One is accomplished by allowing the finder of fact to remain the final judge of the weight and sufficiency of the evidence. The other requires a motion at the appropriate time with the intended result of depriving the fact-finder of the ability even to consider the information. It is obvious from the above language that the DSIs were attempting the latter. They cannot now exhumate the argument by rewriting the position taken in the initial brief. To permit such reversals in the brief on exceptions would render the initial brief meaningless by making the parties' positions moving targets until the brief on exceptions. Moreover, if parties could simply recharacterize every motion to strike as an argument regarding the weight to give a piece of evidence, then evidentiary motion practice in this proceeding would be essentially pointless. The DSIs failed to move to strike the evidence at the appropriate time, and the argument is therefore waived.

Moreover, the supplied data are most certainly relevant to the margin calculation and, even if they are hearsay, the procedures do not categorically require their exclusion. The Administrator certainly agrees that the cost of service data and other forms of data that are subject to "independent verification" are preferable. However, the Administrator also believes that it is important, in light of changes in the power markets, to include relevant data about nontraditional service arrangements that may not be reflected in a cost of service analysis. In fact, BPA has accepted this kind of information in previous Industrial Margin studies. A nearly identical form of data was accepted and used in the 1996 Industrial Margin Study. Ebberts, WP-02-BPA-E-47, at 10. On balance, therefore, the Administrator finds that it is reasonable to include this information in the sample and to give it the same weight as any other included information.

None of this should be interpreted as minimizing the Joint DSIs' legitimate concerns about the availability and reliability of data both now and in the future. There is likely to be increased pressure to ensure confidentiality and a continuing reluctance on the part of utilities to provide the type of information needed to calculate the margin. The reliability of data will continue to be monitored in future cases.

Decision

It is reasonable, under the circumstances presented here, to include the data provided by Utilities No. 5 and No. 14 in the margin study.

15.3 DSI Floor Rate

Section 7(c)(2) of the Northwest Power Act provides that the rate developed pursuant to that section “shall in no event be less than the rates in effect for the contract year ending on June 30, 1985.” 16 U.S.C. §839e(c)(2). This is the so-called “floor rate test.” Simply stated, the floor rate test ensures that BPA recovers revenues from its DSI customers in the current rate test period equal to or greater than the revenues it would recover in the test period using the applicable IP rate in effect on June 30, 1985. Ebberts, WP-02-E-BPA-22, at 10. In the 1985 rate case, the Administrator decided that the IP-83 Standard rate was the appropriate basis for conducting the floor rate test, and that rate has been the basis for the test in every subsequent rate case. 1985 ROD, WP-85-A-02, at 182.

15.3.1 Appropriate Rate Schedule: IP-83 Standard v. IP-83 Premium

Issue

Whether the IP-83 Standard Rate should be replaced by the IP-83 Premium Rate for the 2002-2006 rate period.

Parties’ Positions

PPC argues that the DSIs are being offered up to 1,400 aMW in the form of a firm power block product. PPC Brief, WP-02-B-PP-01, at 54. Therefore, PPC concludes, the applicable “rate in effect” in 1985 which should serve as the basis for the floor rate is the Premium Rate, which was available for the sale of 100 percent firm Federal power to the DSIs. PPC Brief, WP-02-B-PP-01; *see also*, PPC Ex. Brief, WP-02-R-PP-01, at 10. The IOUs and SUB make similar arguments. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS/EN-01, at 44-47; SUB Brief, WP-02-B-SP-01, at 4; *see also*, IOU Ex. Brief, WP-02-R-AC/GE/IP/MP/PL/PS/EN-01, at 34-36, and SUB Ex. Brief, WP-02-R-SP-01, at 4.

BPA’s Position

BPA maintains that the IP-83 Standard rate is the appropriate basis for the floor rate. It establishes an equitable baseline of rate protection for preference customers while maintaining an appropriate degree of stability and predictability in the DSI rates. Ebberts, WP-02-E-BPA-47, at 5.

Evaluation of Positions

The PPC states that the IP-83 Standard rate schedule reflected a product that melded firm service with nonfirm service:

Calculation of the IP-83 Standard Rate melds the cost of providing firm service to the bottom three quartiles of the DSI load, plus first quartile transmission costs allocated in the Cost of Service Analysis, with the generation cost assigned in the WPRDS. Generation costs are assigned based on the opportunity cost of

providing service to the first quartile. Under the IP-83 Standard Rate, all service to the top quartile is priced at the generation portion of the average Nonfirm Energy rate.

PPC Brief, WP-02-B-PP-01, at 54, quoting WP-83-FS-BPA-07, at 41.

The PPC interprets this language to mean that the 1985 Standard rate reflected interruptible service for one-quarter of the DSI loads. *Id.* PPC then argues that service under the IP-83 Standard rate was a product of “lesser quality” than the current DSI service proposal of up to 1,400 aMW in the form of a firm power block product. *Id.* Therefore, PPC concludes, the IP-83 Standard rate was not the “rate in effect” in 1985 for the type of product now being offered, and it should be supplanted by the more applicable IP-83 Premium Rate, which was available in 1985 for the sale of 100 percent firm Federal power to the DSIs. *Id.* at 55.

In testimony, PPC described the difference between the Standard and Premium rates as follows: “The IP-83 Standard rate is for service to DSIs by BPA with 75 percent firm and 25 percent non-firm resources. The IP-83 Premium rate is for service to DSIs by BPA with 100 percent firm resources.” Hansen *et al.*, WP-02-E-PP-06, at 23. Unfortunately, PPC does not account for the fact that service provided to the first quartile was quite reliable and extremely unlikely to be interrupted. In the 1983 rate case, for example, BPA forecasted approximately 76 percent service to the first quartile based on nonfirm resources; however, since the first quartile was also modeled as a market for firm surplus, the end result was a “much higher percentage of service to the first quartile.” 1983 ROD, at 254. Thus, service to the first quartile was reinforced by being served as a priority market for both nonfirm energy and unmarketed firm surplus. Such service cannot accurately be characterized as wholly “nonfirm.”

Again, in 1985, the Administrator described the nature of first quartile service as being a highly dependable quality of service:

[T]he DSI first quartile, under rate case assumptions, would be the first market served with nonfirm energy . . . [Also] the first quartile could be served with provisional drafts, while nonfirm energy sales made under the NF rate are not made using provisional drafts . . . Although BPA operates its resources to serve the first quartile on a firm basis . . . [r]estrictions to the first quartile could occur if either adverse water conditions arose or if BPA were able to make more sales of surplus firm energy at the SP rate than it currently expects . . . Current estimates indicate, however, that surplus firm energy will be available during the rate period . . . [T]he probability is that, even under critical water planning, BPA would have to restrict service to only that portion of the first quartile not served with unsold surplus firm power; that is, power made available during the fish migration assistance period and the precritical period and unsold surplus during the other 9½ months . . .

1985 ROD, at 150.

Thus, BPA not only projected adequate firm surplus to “firm up” the first quartile, but also operated its system in a manner that created a very low probability of first quartile interruption. Even in the worst possible scenarios, a significant amount of top quartile service was, in all respects, firm service. In typical years, when BPA generated nonfirm energy, the entire quartile was firm. *Id.* at 151. As the Administrator observed: “In effect, the DSIs receive a product that BPA attempts to provide as firm while charging only a nonfirm energy price.” *Id.*

Because top quartile service has been essentially firm from an operational standpoint, the question of computing its value has always been difficult. As the Administrator noted in 1985:

On BPA’s system, nonfirm energy is generally available in most years. Because of the nature of DSI operations, the DSIs provide a fairly stable market for nonfirm energy. As a result of this relationship, the value to BPA of the interruptibility of the first quartile is more closely related to the nonfirm energy market than to the acquisition of an alternative resource.

Id. at 203. A similar point was made in 1983:

Assigning costs to the first quartile is a difficult issue because of the unique character of service provided the first quartile. Ideally, the method chosen would reflect the nonfirm nature of the service from a planning perspective, the near-firm nature of the service on an operational basis (that is, service of the first quartile is high on the priority list of uses of nonfirm energy), and the return provisions for the provisional drafts. Unfortunately, it is very difficult to calculate the cost of these service characteristics, either on an embedded cost of service basis or some incremental cost basis.

1983 ROD, WP-83-A-02, at 255.

The unique configuration created by first quartile service does differ, to some degree, from the firm service provided to the DSIs since 1996 and offered again as a result of this proceeding. The question is whether the difference is significant enough to warrant a radical change in the way the floor rate has been calculated. As noted above and in BPA’s testimony, the availability of firm surplus and nonfirm energy in typical years meant that the first quartile was virtually firm. Tr. 1707. Therefore, the product offered under the Premium rate schedule was not an attractive product. In fact, BPA’s testimony indicates that no sales were made under that rate schedule. Tr. 1808. In this vein, it is also important to remember that the floor rate test is a revenue test, *i.e.*, it ensures that the DSI rates will recover revenues at least equal to the revenues recovered under the rate “in effect” on June 30, 1985. This fact, as well as the factors related below, raise numerous questions regarding the wisdom of treating a rate schedule which generated no significant revenues as being “in effect” for purposes of calculating the floor rate.

The 1985 ROD stated that the purpose of the DSI floor rate was to ease the transition from cost-based to equity-based DSI rates for BPA’s non-DSI customers. 1985 ROD, WP-85-A-02, at 180. On that basis, BPA decided not to use the Incentive rate loads and revenues as the basis for the floor rate calculation, even though that rate was actually being used and generating

significant revenues during some parts of the year. *Id.* The rationale was that using the Incentive rate would have lowered the floor rate, potentially harming BPA's non-DSI customers in the transition from cost-based to equity-based DSI rates. *Id.* At the same time, however, certain costs were removed from the IP-83 Standard rate to prevent the floor rate from including inappropriate costs caused by unique and extraordinary historical events. Failure to make these adjustments would have resulted in a "perpetual windfall" to non-DSI customers. *Id.* at 184. Thus, the development of the floor rate reflects the twin goals of providing adequate rate protection without unduly inflating the DSI rates.

The issue of the DSI floor rate was addressed again in the 1987 ROD. At that time, consistency was a major concern, and one issue specifically addressed was whether the BPA methodology for calculating the level of the floor rate would result in a stable floor rate over time. 1987 ROD, WP-87-A-02, at 134. In fact, other parties (including WPAG) supported BPA in arguing for a methodology that would provide "predictability and stability" to the floor rate calculation. *Id.* BPA decided the method for calculating the floor rate would result in a stable floor rate. *Id.* at 135.

PPC's proposal, by contrast, would introduce significant uncertainty into the floor rate calculation. As BPA pointed out in testimony:

The [PPC] testimony identifies a difference in the quality of service being provided to DSIs in this rate case. However, PPC offers no examples where BPA has previously adjusted the floor rate to account for differences in service quality, in spite of the fact that DSIs received 100 percent firm service in the 1996 rate case. Adopting PPC's proposal would raise a number of questions. For example, BPA's current proposal for DSI service is roughly half the current service level. This arguably raises a service quality issue that should also impact the floor, which in turn raises the issue of how to deal with any service quality issue for which no appropriate 1983 analogue can be identified.

Ebberts, WP-02-E-BPA-47, at 5-6.

Instead of providing stability, the PPC proposal would make the floor rate a moving target by opening the door to a plethora of continuing "service quality" arguments that could be raised in support of any number of adjustments to the floor rate. The primary result would be to undermine the stability and predictability that the floor rate has provided for 15 years.

SUB takes issue with a number of arguments posited by BPA in the Draft ROD. SUB argues that BPA erred by using "retrospective logic" in determining that first quartile service to the DSIs was "virtually firm." SUB Ex. Brief, WP-02-R-SP-01, at 4. SUB insists that the IP-83 Premium rate was the applicable rate "in effect" and should be the basis for the floor rate, concluding that firmness of service to the DSIs is a moving target and the firm product sale to the DSIs should drive the floor rate. *Id.* at 5.

The Administrator does not find these arguments persuasive. The statute requires that, in some circumstances, a rate from a prior rate period be used to establish the rates for the current rate

period. 16 U.S.C. §839e(c)(2)(C). It is difficult to understand how that could be accomplished without using, to some degree, “retrospective logic.” BPA’s witness made the salient historical point clearly during cross-examination:

BY MR. MARSHALL:

Q. Standard rate power can be interrupted. Premium rate power cannot be interrupted, it’s firm, right?

A. (Mr. Ebberts) Well, the fact of it was the standard rate was firm. That product was firm.

Q. As it turned out, but it could be interrupted, right?

A. (Mr. Ebberts) It was firm.

Q. Standard rate is firm and premium is firm. Is that what you’re trying to say, Mr. Ebberts?

A. (Mr. Ebberts) We ha(d) 500 megawatts of firm surplus allocated to that top quartile. That load was firm.

Tr. 1797. SUB complains that BPA has made a “moving target” of firmness of service to the DSIs. As indicated above, such a statement is inaccurate. The quality of service to the DSIs has, on a historical basis, has been largely consistent. The existence of a Premium rate that was theoretically available, but never used, provides no basis for making the floor rate itself a moving target.

In summary, the floor rate was intended to provide stable and predictable protection against cost shifts to non-DSI customers without creating a “windfall” for non-DSI customers. The IP-83 Standard rate has been used as the basis for that test since 1985. Now, 15 years into the “transition” from cost-based DSI rates to equity-based DSI rates, this rate case is the first in which the floor rate will set the DSI rate. As calculated in the initial proposal, the floor rate (20.98 mills/kWh) differs significantly, but not dramatically, from the equity based IP rate (19.57 mills/kWh). By contrast, as PPC points out, use of the Premium rate as the basis for the floor rate would increase the DSI rates dramatically, to 25.73 mills/kWh (excluding transmission costs). Hansen *et al.*, WP-02-E-PP-06, at 24. Such a result would not be consistent with establishing a stable and predictable baseline of rate protection without creating a windfall to non-DSIs. Instead, PPCs proposal would introduce a rate disparity that cannot be justified by the facts, given the actual nature of first quartile service provided to DSIs in the 1980s. The floor rate was intended to be protective--not punitive--and such a proposal must be rejected.

Decision

The IP-83 Standard rate has provided a stable, predictable baseline of rate protection since 1985, and will not be replaced by the IP Premium rate as the basis for the floor rate calculation.

15.3.2 Non-Recurring Costs: Surplus Firm Revenue Deficiency

Issue

Whether the surplus firm open market revenue deficiency should be treated as a non-recurring cost and removed from the IP-83 Standard rate for purposes of calculating the floor rate.

Parties' Positions

The DSIs argue that because BPA does not forecast any surplus firm open market revenue deficiency in the upcoming rate period, BPA should remove the corresponding IP-83 revenue deficiency from the floor rate in this case. DSI Brief, WP-02-B-DS-01, at 5; *see also*, DSI Ex. Brief, WP-02-R-DS-01, at 10. Alcoa/Vanalco make a similar argument. They maintain BPA is incorrect in asserting that the floor rate test requires that BPA recover revenues from the DSI customers in the test period equal to or greater than the revenues it would recover in the test period using the applicable IP rate in effect on June 30, 1985. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, citing Ebberts, WP-02-E-BPA-22. Alcoa/Vanalco argue that BPA's description of the floor rate test inappropriately fails to consider the elimination of non-recurring costs (among other things). *Id.*

PPC claims such an adjustment to the statutory floor rate test is not justifiable. PPC Brief, WP-02-B-PP-01, at 55.

BPA's Position

BPA argues that exclusion of the surplus deficiency would simply be an adjustment to reflect market conditions projected in this particular test period. Ebberts, WP-02-E-BPA-47, at 2. Such a cost cannot be characterized as a non-recurring cost, and there is no indication that its continued inclusion in the IP-83 Standard rate creates any kind of windfall for non-DSI customers. *Id.* at 3.

Evaluation of Positions

The DSIs state that, in 1985, the Administrator approved a floor rate methodology based upon the IP-83 Standard rate, which was adjusted to remove costs of the "deferral" and to reflect the fully "phased-in" newly revised Average System Cost Methodology. DSI Brief, WP-02-B-DS-01, at 7, citing 1985 ROD, at 190. The DSIs state that the Administrator rejected other adjustments proposed by the DSIs, but only on the basis that such adjustments were "inappropriate for the limited purpose of determining the DSI floor rate in the 1985 rate filing." *Id.* at 8.

The DSIs then note that in the 1996 rate case, after the IP/PF link expired, the Administrator again faced arguments from the DSIs regarding the need to remove certain additional non-recurring costs from the floor rate. *Id.* The DSIs state that the Administrator affirmed BPA's position from the 1985 rate case that the floor rate, like all other rates, is prospective in nature and must be adjusted in setting future rates. *Id.* *See* 1985 ROD, at 185. They also note

that the Administrator agreed that “the DSIs are correct that non-recurring costs should be excluded from future rates, including the floor rate.” DSI Brief, WP-02-B-DS-01, at 8, quoting 1996 ROD, WP-96-A-02, at 220. *Id.* However, since the equitable 7c(2) rate exceeded the floor rate, the Administrator did not rule on the merits of the DSIs’ proposed adjustment. *Id.* For that reason, the DSIs have proposed that the Administrator consider the issue in the present proceeding.

The DSIs state that the IP-83 Standard rate and the 1985 floor rate were developed at a time when BPA expected to have surplus firm power in excess of its existing and projected contractual obligations. *Id.* at 9. They maintain, as well, that in 1983 and again in 1985, BPA forecasted that a significant portion of this surplus firm power would be sold on the open market at prices below BPA’s allocated costs of the power. *Id.* This created a revenue deficiency that had to be recovered through other power rates. *Id.* In 1983, the surplus power was deemed to consist of the exchange power, and the revenue deficiency was allocated primarily to the IP-83 rate. *Id.* Now, however, BPA’s regional customers seek to purchase power in excess of BPA’s expected power inventory. *Id.* The DSIs argue that because BPA does not forecast any surplus firm open market revenue deficiency in the upcoming rate period, BPA should remove the corresponding IP-83 revenue deficiency from the floor rate in this case. *Id.* More broadly, the DSIs believe that the floor rate should be reviewed, and if necessary revised, in each rate case to assure that costs which do not recur in the BPA revenue requirement for that specific case are not included in the floor rate. *Id.*

BPA disagrees with the DSI argument. In 1985, the only time the issue has been considered on its merits, the Administrator removed only two items from the IP-83 rate on finding that they were non-recurring costs. In 1985, the Administrator recognized that “it is appropriate to examine the IP-83 rate structure to determine if any components might provide BPA’s non-DSI customers a perpetual windfall.” 1985 ROD, at 186. The Administrator found further that two of the DSIs’ proposed adjustments had merit, *i.e.*, “the adjustments for the deferral and the phase-in of the new ASC methodology.” *Id.* at 187. With regard to the deferral, the Administrator said:

The treatment of the deferral was an unusual attempt by BPA to recover in its 1983 rates the unrecovered costs from previous rate filings. As a result, the 1983 rates were increased for previously unrecovered costs. It would be unfair to the DSIs to incorporate these costs in post-85 rates by using an IP-83 rate that has not been adjusted to account for the effects of the deferral.

Id.

Thus, the Administrator found that this event was “unusual.” In other words, there was a very low probability that the event would occur again and then be treated, for ratemaking purposes, in a manner that would be analogous to treatment of the deferral in 1983. Instead, leaving the deferral costs in the IP-83 Standard rate was likely to result in a windfall for non-DSI customers by collecting multiple times the amount of deferral costs originally allocated to the DSIs. *Id.* at 188.

Similarly, the Administrator noted that “[t]he phase-in of the new Average System cost methodology is also an unusual event that unduly affects the average 1983 DSI rate.” *Id.* The phase-in of the new methodology was “a short-term measure adopted to benefit other customers” and its specific purpose was “to avoid a sudden large increase in retail rates.” *Id.* Retaining those costs in the IP-83 Standard rate would result in an “artificially high” DSI rate and impede “a smooth transition to post-85 rates.” *Id.*

Thus, in both instances, the removed cost had been triggered by an unusual event, and that event was dealt with, as a matter of policy choice, in a manner that had the effect of temporarily skewing the IP-83 Standard rate. Continued inclusion of such an unusual temporary adjustment would have, in both instances, inflated the DSI rate artificially, disrupting the transition from cost-based to equity-based rates.

The same cannot be said for the surplus firm open market revenue deficiency. First, it is not triggered by an unusual event, but is instead a natural product of market forces which are constantly at work. As the Administrator noted, in denying the DSIs’ request in 1985 for surplus power adjustment: “Both the availability and marketability of surplus power is subject to a great deal of uncertainty.” *Id.* at 189. While the DSIs’ optimistic portrayal of BPA’s future market position is refreshing, it is by no means certain. It should be recalled that a mere four years ago, the Administrator published a ROD which included the following statement:

BPA’s customers, and the large industrial customers that many of them serve, all are searching actively for new lower cost suppliers . . . Parties representing every segment of BPA’s customer base, investor-owned utility, direct-service industry, and public utility, have acknowledged the fact that BPA is faced with an increasingly competitive market . . . Most have urged BPA to take the actions, consistent with its statutory obligations, that are necessary to become more competitive . . . These same parties have acknowledged that BPA must compete in this market if it is to stay in business and collect sufficient revenues to meet its statutory obligations.

1996 ROD, at 16.

While BPA appears poised to be a low-cost provider for the coming rate period, that standing, in some ways, when compared to 1996, simply reflects the fact that current market conditions can and do change in a fairly short time frame. As BPA’s testimony pointed out:

There are good reasons why the surplus deficiency should not be characterized as non-recurring. BPA is making long-term (five-year) purchases in advance of the close of Subscription for approximately 1,100 average megawatts to augment the Federal Base system. It is possible that at some time during the next five year rate period, federal loads could change, and therefore, BPA could experience a firm revenue deficiency of the nature found in the Industrial Firm Power (IP-83) Standard rate. In addition, in any future rate case, the full costs of any BPA firm surplus may exceed market prices for various reasons.

Ebberts, WP-02-E-BPA-47, at 2.

Thus, the surplus deficiency is not “unusual” in the sense that term has been applied to previous adjustments. Moreover, the 2002 DSI rates are well below projected market prices, and they do not differ greatly from the rates of other customers. Thus, continued inclusion of the surplus revenue deficiency does not appear to be artificially skewing the DSI rates, creating a perpetual windfall for other customer classes, or causing serious disruption to the smoothness of the transition to a new rate directive that has now been applicable for 15 years. In sum, the DSI arguments for another adjustment are not persuasive.

The position adopted by Alcoa/Vanalco is even less compelling. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 70-71. Alcoa/Vanalco state that the purpose of the floor rate is to keep costs paid by the DSIs from being shifted to other customers. *Id.* at 70, 71. They state that to the extent BPA costs that were included in the rates in effect for the year ending July 30, 1985, are eliminated or reduced, the floor rate can be reduced without cost shifts to other customers. *Id.* at 70. They go on to maintain that BPA is incorrect in asserting that the floor rate test requires BPA to recover revenues from the DSI customers in the test period equal to or greater than the revenues it would recover in the test period using the applicable IP rate in effect on June 30, 1985. *Id.* at 71, citing Ebberts, WP-02-E-BPA-22, at 10. Such an assertion is inappropriate, they maintain, because it does not consider either the elimination of non-recurring costs, or the change in services provided through power rates in this case. *Id.*

Regardless of how the purpose of the floor rate is stated, the statutory directive is clear that a comparison should be made between proposed rates and the rates in effect in 1985. BPA has consistently treated the test as a revenue test and continues to believe that such a test is reasonable. Moreover, the argument that BPA’s conception of the floor rate test fails to consider the elimination of certain types of costs is somewhat bewildering, inasmuch as those very issues appear to have been raised, recognized, and thoroughly considered in this proceeding.

PPC states that the adjustment to the statutory floor rate requested by the DSIs is not justifiable. PPC Brief, WP-02-B-PP-01, at 55. The PPC goes on to argue, however, that if BPA determines it is appropriate to adjust the floor rate to reflect changed market conditions, then it must similarly be appropriate to adjust the floor rate to correct for the service quality provided the DSIs under current market conditions. *Id.* The PPC states that to do otherwise would be arbitrary. *Id.* As noted above, BPA disagrees with the DSI position and is not removing the surplus deficiency as a non-recurring cost. It is not necessary, then, to address the service quality issue in this section, although that issue is fully addressed above.

Decision

The surplus firm open market revenue deficiency will not be treated as a non-recurring cost and will be included in the IP-83 Standard rate for purposes of calculating the floor rate.

15.3.3 Removal of Transmission Costs: IP-83 Standard v. IP-83 Premium

Issue

Whether it was appropriate for BPA to remove transmission costs from the IP-83 Standard rate to make an accurate floor rate comparison, in light of the fact that the IP-02 rate is for an undelivered product.

Parties' Positions

PPC argues that BPA is required to ensure that the total BPA rate to the DSIs fulfills the floor rate directive, and that BPA is therefore required to ensure that the transmission component of the floor rate test is performed. PPC Brief, WP-02-B-PP-01, at 53; *see also*, PPC Ex. Brief, WP-02-R-PP-01, at 11-12. The IOUs argue that the DSI floor rate test must compare the DSI floor rate (which bundled power and transmission rates) with DSI rates being established for the period beginning October 2001 for both power and transmission. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 44.

The DSIs agree in part with BPA. The DSIs point out that BPA has, as a matter of policy, unbundled its power and transmission rates in accordance with policies and standards developed by FERC and that BPA recognized that it was appropriate to adjust the floor rate to produce a power-only floor rate comparable to the IP-02 rate. DSI Brief, WP-02-B-DS-01, at 10.

BPA's Position

The IP rates, including the IP-83 Standard rate, have always been delivered product rates. Ebberts, WP-02-E-BPA-22, at 10. This means that both power and transmission costs were included in the test-period IP rate and IP-83 Standard rate. Beginning in this rate case, there will be separate rate cases for power and transmission. *Id.* To do this “power-only” comparison, the transmission costs included in the IP-83 Standard rate were removed. *Id.* Adjusting the IP-83 Standard rate in this manner, by removing the transmission costs from the rate, is the most straightforward and accurate approach. *Id.*

Evaluation of Positions

PPC states that section 7(c) of the Northwest Power Act sets forth the statutory rate directives applicable to the DSIs. PPC Brief, WP-02-B-PP-01, at 52. The PPC argues that one of those directives requires that the DSI rates “shall in no event be less than the rates in effect for the contract year ending June 30, 1985.” *Id.* at 53. The PPC states that the statutory language is mandatory, not permissive. *Id.* PPC also argues that, while the BPA sale to a DSI customer is discretionary, the rate directives governing such sale are not. *Id.* Thus, the “floor rate” for a BPA sale to any DSI consists of “rates in effect for the contract year ending June 30, 1985.” *Id.* In 1985, such rates included transmission costs. *Id.*, citing Hansen *et al.*, WP-02-E-PP-06, at 21-22. Because BPA is required to ensure that the total BPA rate to the DSIs fulfills the floor rate directive, PPC insists that BPA must ensure that the transmission component of the floor rate test is performed. *Id.* The PPC states that when it is performed, whether in this wholesale power

rate proceeding or in a subsequent transmission rate proceeding, is of less relevance than the fact that transmission must be accounted for in the Administrator's determination of compliance with the floor rate test. *Id.* PPC expresses concern that, at the hearing, this witness could not say whether the BPA transmission rate case would address this issue. *Id.*, citing Tr. 1707.

Finally, the PPC argues that the separation of the two BPA rate proceedings cannot be used as a means to avoid a necessary component of the statutorily mandated DSI rate directives. *Id.* at 54. If the floor rate test is not completed in this case, it must be completed in the transmission case. *Id.* However, according to PPC, that would prevent the Administrator from making a final determination regarding these proposed power rates as required by the statute, 16 U.S.C. §839e(c)(1), until after the transmission rate case is completed. *Id.* In either case, functional separation of the business lines may not be relied upon to avoid a statutory directive that the Administrator is charged to employ. *Id.*

The IOUs offer fundamentally the same argument. The IOUs state that section 7(c)(2) of the Northwest Power Act requires that the DSI rate be no less than the rate in effect on June 30, 1985. IOU Brief, WP-02-B-AC/GE/IP/MP/PL/PS-01, at 86. The IOUs note that the DSI rate in effect at that time included both power and transmission charges. *Id.* The IOUs also maintain that the Northwest Power Act specifically requires consideration of not only power, but also transmission or delivery costs in establishing DSI rates. *Id.* Therefore, the DSI floor rate test must compare the DSI floor rate (which bundled power and transmission rates) from the 1985 rate case with DSI rates being established for the period beginning October 2001 for both power and transmission. *Id.*

The IOUs claim that BPA has failed to correctly perform this statutorily required floor rate test in its initial proposal by removing transmission costs from its floor rate test calculations. *Id.* The IOUs state that BPA concedes it is ignoring costs and rates for transmission in the floor rate test: "Beginning this rate case, there will be separate rate cases for power and transmission. Therefore, the floor rate test will be done for power only." *Id.*, quoting Ebberts, WP-02-E-BPA-22, at 10.

The IOUs claim that BPA cannot ignore the statutory mandate to conduct a floor rate test for DSI rates for power and transmission merely because it has decided that "there will be separate rate cases. . . ." *Id.*

The IOUs also claim that BPA's proposal in this proceeding fails to establish a floor rate that is consistent with the statutory requirements of the Northwest Power Act. *Id.* The IOUs state that the PPC proposed that BPA resolve this problem by committing to include the transmission costs in a floor rate in the transmission case. *Id.* In its rebuttal testimony on this issue, BPA asserted that "[PPC's] proposals [to incorporate the transmission costs into the floor rate] are beyond the scope of the power rate case and will be dealt with in the transmission case." *Id.*, quoting Ebberts, WP-02-E-BPA-47, at 5. The IOUs claim that during cross-examination the same witness testified that he: (1) did not know if PPC's proposals to adjust BPA's floor rate for transmission costs were appropriate for the transmission case; (2) did not know what would constitute an appropriate subject for the transmission case; and (3) was not even aware of

whether alternative proposals for calculating the transmission component of the floor rate test would be considered in the transmission case. *Id.*

The IOUs claim that BPA is simply failing to take the steps necessary to calculate the DSI floor rate. *Id.* at 87. The IOUs claim that the DSI power rate adopted in this proceeding must contain a provision for adjusting that rate, depending upon a comparison (in or after the transmission rate case) of the floor rate with the sum of the DSI power and transmission rates (PPC proposed a similar approach involving a “true-up” of the floor rate in the transmission case). *Id.* The IOUs state that subsequent floor rate tests, for periods after the BPA two-year transmission rate period, will also be required after development of BPA’s transmission rates for each subsequent period. *Id.*

The DSIs note that BPA has, as a matter of policy, chosen to unbundle its power and transmission rates in accordance with policies and standards developed by the FERC. DSI Brief, WP-02-B-DS-01, at 10. The DSIs state that in its testimony, BPA staff recognized that it was appropriate to adjust the floor rate to produce a “power-only” floor rate comparable to the IP-02 rate. Ebberts, WP-02-E-BPA-22, at 10. *Id.* The DSIs state that BPA staff proposed to adjust the IP-83 Standard rate for this purpose by simply removing the identified transmission costs included in the IP-83 rate. *Id.* at 11.

The DSIs agree that it is appropriate and necessary to make the proposed adjustment, but they also go on to argue that the adjustment is not sufficient. *Id.* The DSIs claim that BPA’s proposed adjustment to the floor rate by itself is inadequate to produce a power-only floor rate comparable to the IP-02 rate. *Id.* The DSIs state that FERC requires not only unbundled transmission rates, but also rates for unbundled ancillary services. *Id.* The DSIs state that as explained in BPA’s direct testimony, BPA’s TBL will need generation inputs from the FCRPS to provide ancillary and other transmission services. *Id.*, citing DeClerck *et al.*, WP-02-E-BPA-26, at 1-2. The DSIs state that BPA allocated a portion of its generation costs to the TBL to be recovered in TBL rates for transmission and ancillary services. *Id.* The DSIs claim that in order to develop a power-only floor rate and avoid double-charging the DSIs for the cost of generation inputs for ancillary services, BPA must subtract the cost of such generation inputs from the IP-83 rate. *Id.*; *see also*, DSI Ex. Brief, WP-02-R-DS-01, at 10.

The DSIs state that unfortunately, BPA did not calculate and separately identify the cost of generation inputs to transmission and ancillary services in 1983. *Id.* There was no need to do so, because BPA’s products were fully bundled. *Id.* Therefore, the certain and completely straightforward method used by BPA to adjust the IP-83 rate for transmission costs is not directly available for the generation inputs. *Id.* The DSIs propose a methodology for identifying the costs of generation inputs in 1983 that they claim is the functional equivalent of BPA’s treatment of the transmission costs in the floor rate in this case. *Id.* at 10-11.

The DSIs state that the need for ancillary and other services to which BPA is providing generation inputs was not created by FERC’s coining the term “ancillary services”; the need arises from the physics of the generation and transmission of power. *Id.* at 11, citing DeClerck *et al.*, WP-02-E-BPA-26, *passim*. Moreover, the FCRPS that supplies such services and the WSCC operating requirements are essentially the same now as they were in 1983. *Id.*

The DSIs therefore conclude that it is reasonable to assume that the costs of generation inputs for ancillary services made up an equivalent percentage of BPA's total generation costs in 1983 to what they do today. *Id.* This follows from the fact that the Federal system is today as it was in 1983, 30 Federal hydro projects plus WNP-2. *Id.*

The DSIs state that in this case, BPA proposes to allocate costs equal to 3.5 percent of its generation revenue requirement to the generation inputs for ancillary services. *Id.* The generation revenue requirement allocated to the IP-83 rate in 1983 was \$89.53 million, and 3.5 percent of such costs is \$3.133 million. *Id.* The DSIs claim that this is a reasonable estimate of the costs of what are now called "generation inputs" that were allocated to the IP-83 rate. The DSIs state that this cost should be removed from the IP-83 Standard rate before the floor rate test is applied to a power-only IP-02 rate that does not recover the costs of such generation inputs. The DSIs state that leaving the costs of generation inputs in the floor rate would simply overcharge the DSIs without furthering any purpose of the floor rate test. The DSIs state that if this adjustment is adopted, the floor rate would be reduced from 20.98 mills/kWh as calculated by BPA to 20.81 mills/kWh. *Id.*

The DSIs state that BPA staff criticized this proposed adjustment as analytically inconsistent with the manner in which BPA adjusted the floor rate for transmission costs. DSI Brief, WP-02-B-DS-01, at 11. The DSIs agree with BPA staff that subtracting generation input costs that could be identified directly from the 1983 rate studies would be ideal. *Id.* But this option is simply not available. *Id.* at 12. The DSIs state that as noted above, there was no reason for BPA to separately identify such costs in 1983, and they were not separately identified. *Id.* The DSIs state it is not the case, however, that the methodology proposed by the DSIs is analytically inconsistent with BPA's transmission methodology, as alleged by BPA staff. *Id.*

The DSIs state that they did not propose that BPA use the cost of ancillary services in the current rate period as a surrogate for such costs in 1983. *Id.* The DSIs state that they proposed that, given the same physical system and operating requirements, it is reasonable to assume that the same percentage of generation costs were needed for generation inputs for ancillary services in 1983 as in the pending case. *Id.* The DSIs propose applying that percentage to the 1983 generation revenue requirement allocated to the IP-83 rate. *Id.* The DSIs state that the methodology is consistent with the methodology used by BPA for transmission costs in that it provides a proxy for calculating specific costs that were included in the IP-83 rates, and it is a reasonable methodology to avoid double-charging the DSIs for the cost of the generation inputs for ancillary services. *Id.*

As BPA points out, the IP-02 rate is an undelivered power rate. Ebberts, WP-02-E-BPA-22, at 10. It would have been inappropriate to compare an undelivered product rate to a delivered product rate in the floor rate test. *Id.* To have done so would have created an artificially high floor rate that included costs not present in the product being offered to the DSIs. As BPA's witness explained:

Removing transmission costs from the calculation does not lower the floor rate in the sense that it permits the DSI customers to acquire power at a lower cost from BPA. Rather, it merely allows BPA to compare an unbundled test period power

rate to an unbundled power floor rate, and no changes have been made, or are being proposed at this time, to any power costs in the IP-83 rate. Therefore the floor rate, after adjusting for the transmission component and substituting test period billing determinants, is unchanged.

Id. at 11.

Failure to make such an adjustment would be both unfair and arbitrary. Ultimately, BPA decided that the most straightforward approach to resolving this issue would be to remove known transmission costs from the IP-83 Standard rate. *Id.* BPA had considered an alternative methodology which was rejected:

We also considered estimating the transmission rates that the DSIs may pay in the next rate period and adding those costs to the proposed IP-02 rate. Adjusting the IP-83 Standard rate by removing the transmission costs is the most straightforward and accurate approach. The transmission costs included in the IP-83 Standard rate are known and removing them from the rate involved no guesswork. However, transmission costs and rates that will be applicable to DSI customers in the next rate period are not known at this time, and an attempt to project those future costs would not be as accurate as removing known identifiable costs.

Id.

In other words, the alternative approach would have been to make a projection of transmission rates and use this estimate, knowing that it could later prove to be inaccurate. *Id.*

The DSIs agree with BPA's position that it was appropriate to perform a floor rate test based on a straightforward comparison of undelivered product rates. DSI Brief, WP-02-B-DS-01, at 10. However, the DSIs then claim that BPA did not go far enough, because it did not subtract additional costs beyond known transmission costs from the IP-83 Standard rate for what the DSIs claim should be ancillary service costs. *Id.* As BPA has pointed out, BPA accepted the method of subtracting known transmission costs from the IP-83 standard because it was a straightforward and accurate approach. Ebberts, WP-02-E-BPA-47, at 4. Adopting this method meant that BPA had to accept that it was not perfectly clear what specific transmission services were included in these costs. *Id.* It would not be possible to say with certainty whether some or none of these costs were associated with what would be considered ancillary services today. *Id.* In other words, the costs were not identified with enough specificity that there was any certainty of a high degree of accuracy with respect to separating transmission from ancillary service costs. For that reason, BPA determined that further analysis into costs not identified as transmission would not be reasonable, since there was no basis for determining whether new costs were being identified or if a cost was being double counted. *Id.*

This problem is also inherent in the DSI proposal to use the percentage of its generation revenue requirement to the generation inputs for ancillary services in this rate case (3.5 percent) as a proxy for the percentage of generation revenue requirement for ancillary services in the IP-83

rate that would be subtracted from the IP-83 Standard rate. DSI Brief, WP-02-B-DS-01, at 11. Again there is no way of knowing with certainty whether some of those costs are already included in the removal of identified transmission costs. Ancillary service rates are part of a relatively new pricing construct that attempts to identify and separate all of the services associated with providing reliable transmission. Ebberts, WP-02-E-BPA-47, at 4. Ancillary services were not identified at the time the IP-83 Standard rate was developed. *Id.* It is not clear that correlating costs recovered through that rate with present-day ancillary service cost projections is an accurate means of unbundling the floor rate. *Id.* This is why BPA believes that the DSI methodology could be used only if it were used for both ancillary service costs and transmission costs. Despite the DSIs' contention to the contrary, this would provide some assurance that there is no double-counting of costs that have already been subtracted from the IP-83 rate. *Id.*

As to the arguments of the IOUs and PPC regarding assurance that the transmission costs will be dealt with in the transmission rate case, PBL should not and does not have the authority to mandate policy or practice in the TBL rate case. Ebberts, WP-02-E-BPA-47, at 5. The PBL has said no more on the issue than that. Indeed, it would be inappropriate for PBL to do any more than that, in light of the functional separation of the business lines that BPA has undergone since the last rate case. As noted elsewhere, BPA is attempting to comply with the FERC restructuring orders by, among other things, adhering to FERC-approved Standards of Conduct and meeting comparability requirements under an open access transmission tariff. PBL will participate as a party in the transmission rate case and will be subject to the same *ex parte* restrictions as any other party. It would be inconsistent with these policies for PBL to make representations on behalf of TBL regarding the conduct and content of its rate case. *Id.*

Decision

BPA's method of removing identifiable transmission costs in the IP-83 Standard rate creates a reasonable parity between the floor rate and the unbundled IP-02 rate. In the interest of both fairness and accuracy, the floor rate test should be done for power only.

15.4 DSI Value of Reserves

Issue 1

Whether BPA should set a maximum rate for the DSI value of reserves credit for Supplemental Reserves under the IP-02 rate schedule equal to the cap on the inter-business line charge for operating reserves generation inputs.

Parties' Positions

No party addressed this issue in its initial brief.

BPA Position

BPA proposed a maximum rate for the DSI value of reserves credit for Supplemental Reserves under the IP-02 rate schedule equal to the cap on the inter-business line charge for operating reserves generation inputs.

Evaluation of Positions

Rate directives in the Northwest Power Act applicable to the DSIs require that the value of reserves credit be established in the rate case. 16 U.S.C. §839e(c)(3). Even though PBL is not presently forecasting purchases of Supplemental Reserves from the DSIs, PBL needs the flexibility to purchase Supplemental Reserves from the DSIs without initiating a separate section 7(i) process. *McRae et al.*, WP-02-E-BPA-29, at 8. PBL proposed a flexible rate with a cap that will permit BPA to negotiate a price according to the quality of the reserves provided by the DSIs, if any. *Id.* at 4. The cap is equivalent to the cap on inter-business line charges for generation inputs for operating reserves. *Id.* at 6. Generation inputs for operating reserves have essentially the same electrical characteristics as the highest-quality Supplemental Reserves that PBL might purchase from the DSIs. *Id.* Thus, it is appropriate to cap the DSI Supplemental Reserves credit at the embedded cost price that PBL charges TBL for similar services. *Id.*

Decision

BPA will set a maximum rate for the DSI value of reserves credit for Supplemental Reserves under the IP-02 rate schedule equal to the cap on the inter-business line charge for operating reserves generation inputs.

Issue 2

Whether BPA should establish certain guidelines to help define the Supplemental Reserves PBL may purchase from the DSIs and to identify criteria relevant to the negotiated price PBL may pay for those reserves.

Parties' Positions

No party addressed this issue in its initial brief.

BPA's Position

BPA proposed certain guidelines to help define the Supplemental Reserves PBL may purchase from the DSIs and to identify criteria relevant to the negotiated price PBL may pay for those reserves. *McRae et al.*, WP-02-E-BPA-29, at 6-7.

Evaluation of Positions

Supplemental Reserves include interruptible load. *Id.* at 2. PBL proposed a flexible rate with a cap that will permit BPA to negotiate a price according to the quality of the reserves provided by

the DSIs, if any. *Id.* at 4. The suitability and quality of the Supplemental Reserves will be measured by whether they have certain characteristics, some of which are required and others optional. *Id.* at 6. Any Supplemental Reserves purchased by PBL must be consistent with current NERC, WSCC, NWPP, and other applicable reliability criteria, presently including, but not limited to, the following:

1. The interruptible load must be offline within 5 minutes after a call by BPA;
2. In the event of a system disturbance, the interruptible load must be accessible prior to a request for reserves from other NWPP parties; and
3. The interruptible load must be available to be offline for up to 60 minutes.

Id. In addition to these required characteristics, the issues identified below will help define when PBL may pay the maximum value for Supplemental Reserves:

1. The extent to which PBL has discretion over when and how to use all reserves and to determine what resources to call on in the event of a system disturbance; and
2. Whether there are limitations on the number of times or total minutes the reserves may be utilized.

Id. These criteria should provide BPA and the DSIs useful guidance in negotiating the price of any Supplemental Reserves PBL may wish to purchase from the DSIs.

Decision

BPA will establish the guidelines outlined above to help define the Supplemental Reserves PBL may purchase from the DSIs and to identify criteria relevant to the negotiated price PBL may pay for those reserves.

15.5 Compromise Approach

15.5.1 Introduction

On December 21, 1998, BPA issued the Power Subscription Strategy ROD. The Subscription Strategy ROD describes BPA's position on a number of issues, including the availability of Federal power post-2001, the approach BPA plans to use in selling power by contract with its customers, the products from which customers can choose, and frameworks for pricing and contracts. Subscription Strategy ROD, at 1.

In the Subscription Strategy ROD, BPA stated that it expected to meet DSI loads, but noted that the actual level of service to the DSIs was contingent on the availability of power remaining after the close of the Subscription window. 64 Fed. Reg. 44318, 44322. The Subscription Strategy ROD further stated that BPA was not prepared at the time of issuing the ROD to make a number of final decisions, including decisions regarding augmentation to serve DSI load. *Id.*

Subsequent to the Subscription Strategy ROD, but prior to the start of the rate proceeding, BPA met with the DSIs on several occasions to address some of the DSIs' service issues left unresolved in the Subscription Strategy ROD. Berwager *et al.*, WP-02-E-BPA-38, at 2. BPA and the DSIs exchanged various service proposals, none of which was mutually acceptable. Ultimately, BPA, with help from the DSIs, crafted a proposal called the Compromise Approach.

The Compromise Approach proposal is dated June 17, 1999, and by its own terms, is "the approach that BPA would propose as part of the initial proposal for the upcoming rate case if the DSIs are willing to support it." Berwager *et al.*, WP-02-E-BPA-09, Attachment 1, at 1 (Compromise Approach). The Compromise Approach includes a proposed rate and a proposed allocation of power for service to the DSIs. With respect to power allocation, the Compromise Approach provides that "1,500 MW of power will be made available to the DSIs," which "represents a large portion (three-fourths) of the load placed on BPA during the previous five years at a cost-based" rate. *Id.* at 2. With respect to price, the Compromise Approach proposal states that "the price for the 1,500 MW is \$23.50 per MWh." *Id.*

The Compromise Approach proposal was received by the majority of the DSIs with appreciation and support. In a letter to BPA, the President of Goldendale Aluminum Co., and Northwest Aluminum Co., stated:

I want to begin by expressing my thanks to Paul Norman, Syd Berwager and the rest of the BPA staff for their efforts to put together a compromise for BPA service to its Direct Service Industrial customers (DSIs).

The attached June 14, 1999 "Compromise Approach" for BPA service to the DSIs during the period FY 2002-2006 is a major step by BPA to address concerns about our survivability in the PNW. While there still are several important open issues to be decided during the upcoming rate case, the Compromise Approach does provide a framework to meet the needs both of BPA and our company and employees. Our company will support the framework of the Compromise Approach in the rate case and other venues, and work with you to ensure that all open issues are resolved in such a way that the end result is something that works for both our company and BPA.

Cross-Examination Exhibit, WP-02-E-AL-32, at 6, 8.

Similarly, Columbia Falls Aluminum Company (CFAC) stated that it:

. . . very much appreciates BPA's efforts to develop a viable approach to providing power to CFAC and other DSI customers. The Compromise Approach dated June 14, 1999, does not answer all of the issues of concern to CFAC exactly as we would have preferred, but it does provide a solid basis for continuing our dialog in the rate case. It is the fruit of some very hard work by Paul Norman and his staff and we believe they have carefully listened to DSI concerns and have honestly created a good starting point. We urge you to include the Compromise Approach in the initial proposal for the upcoming power rate case.

Cross-Examination Exhibit, WP-02-E-AL-32, at 14.

A letter from Reynolds Aluminum is in accord, stating that the Compromise Approach proposal “is a step in the right direction, and a positive initial proposal for the upcoming rate case. Reynolds supports you moving forward with the rate case, and supports including this proposal for continuing cost-based service to Reynolds as part of BPA’s initial rate case filing.” Cross-Examination Exhibit, WP-02-E-AL-32, at 4.

Indeed, even Alcoa expressed its support, stating:

Alcoa, and I personally, appreciate the effort that you and your staff have made attempting to craft a proposal that would meet Alcoa’s needs as well as those of BPA and other stakeholders. While the compromise proposal retains the service and costs framework proposed by BPA, I recognize that significant progress has been made over the past few weeks towards that common goal.

I believe that elements of BPA’s approach have merit, and that our discussions have been productive. Alcoa does not see the need to cut discussions short in order to enter immediately into a formal rate case. However, if you believe you cannot delay the rate case, the Compromise Approach should be included in your initial rate proposal so it can evolve into a truly workable solution through that process.

Cross-Examination Exhibit, WP-02-E-AL-32, at 16.

Although the majority of the DSIs voiced clear support for the Compromise Approach proposal, the letters were not all uniform and identified various issues of concern. As such, BPA sent concurrence letters to the DSIs, with the Compromise Approach proposal attached. Berwager *et al.*, WP-02-E-BPA-09, Attachment 1, at 1 (prototype concurrence letter). In the concurrence letters, BPA stated:

[R]ecent letters BPA received from the DSIs in support of BPA making this proposal varied greatly in their contents. The letters did not address, in a clear and consistent manner, issues that are important to BPA in making this important decision. This letter is intended to create the clarity necessary for BPA to decide that BPA has the support necessary to move forward with the Compromise Approach proposal in the rate case initial proposal. Without concurrence by the DSIs on the following issues, BPA will not be able to move forward with that proposal. Instead, the initial proposal will have to reflect an earlier proposal (the so-called Targeted Augmentation Approach) BPA placed before the DSIs on April 26, 1999.

Id.

BPA requested, among other things, that DSIs accepting the Compromise Approach proposal not challenge that proposal in the rate case and not litigate the Compromise Approach proposal if it were ultimately adopted in BPA's final ROD. Berwager *et al.*, WP-02-E-BPA-09, Attachment 1.

BPA received signed concurrence letters from the majority of the DSIs. However, two DSIs, Alcoa and Vanalco, declined to accept the Compromise Approach proposal. Alcoa and Vanalco stated that they remained dissatisfied with the proposed price and allocation of power contained in the Compromise Approach proposal, and wanted to retain all rights to challenge BPA's proposal in the rate case and in any other forum. Speer *et al.*, WP-02-E-AL/VN/EG-01, Attachments 2 and 3.

Given that Alcoa and Vanalco rejected the Compromise Approach, BPA considered withdrawing the proposal. Berwager *et al.*, WP-02-E-BPA-38, at 2. However, BPA decided that withdrawing the proposal could have considerable adverse consequences to the DSIs that elected to accept the Compromise Approach. As stated in BPA's initial testimony:

While BPA did consider taking the Compromise Approach off the table in light of the fact that two DSIs elected not to sign the agreement, BPA felt that doing so would defeat its objective of supporting continued DSI operations and employment in the region, consistent with its many other rate case goals. BPA believed also that it would be appropriate to move forward with the proposal on behalf of the DSIs who had said they accepted it as part of the initial proposal and would be willing to support it.

Id.

As a result, in the Federal Register Notice announcing the rate case, BPA stated that the Compromise Approach proposal would be included in BPA's initial proposal and subject to review and scrutiny in the rate case. As stated therein,

BPA does not intend to conduct a separate public process to take comments on this [Compromise Approach] proposal. Therefore, parties to the rate case may raise and discuss any issues regarding BPA's proposal to serve the DSIs including any issues regarding the potential effects of this proposal on BPA's rates.

64 Fed. Reg. 44322.

In addition, because Alcoa and Vanalco rejected the Compromise Approach proposal, BPA was left with a choice of either proposing not to serve these two DSIs at all, or serving them under the terms contained in the proposal to the DSIs that preceded the Compromise Approach proposal, the so-called Targeted Augmentation Approach. Berwager *et al.*, WP-02-E-BPA-38, at 3. BPA elected the latter approach. Pursuant to the Targeted Augmentation Approach, BPA proposed to offer up to 230 aMW to these two customers at a rate of 25.0 mills/kWh. *Id.*;

Berwager *et al.*, WP-02-E-BPA-09, at 2. BPA's reasons for proposing service to Alcoa and Vanalco under the Targeted Augmentation Approach are discussed in section 15.5.4, *infra*.

As a result, BPA's proposal for service to the DSIs was described in BPA's initial testimony as follows:

BPA has developed what is called the 'Compromise Approach' for service to the DSIs. Under this approach, BPA is proposing to offer the DSIs up to 1,440 aMW in the form of a firm power block product. This power will be allocated among the DSIs based on each DSIs purchases under the current Industrial Firm Power (IP-96) rate, and will be sold under the IP Targeted Adjustment Charge (IPTAC) rates. For some of these DSIs, BPA is proposing an IPTAC rate of 23.5 mills/kWh for a flat block of power that is about 75 percent of what they are currently buying. BPA expects to sell 1,210 aMW to these customers. For other DSIs [Alcoa and Vanalco] that are currently buying power under the IP-96 rate, BPA is proposing an IPTAC rate of 25.0 mills/kWh for a flat block of power that is about 60 percent of what they are currently buying. Under the proposal, these customers would be eligible to purchase up to 230 aMW, but there is some uncertainty regarding how much of this amount will be purchased.

Id.

Alcoa and Vanalco have expressed continuing dissatisfaction with the Compromise Approach proposal, as well as BPA's proposal in this rate proceeding, to serve them with up to 230 aMW at 25.0 mills/kWh. They filed lawsuits in Federal court to enjoin the rate case, implementation of the Compromise Approach proposal, and the Subscription Strategy ROD. Their cases were dismissed for lack of jurisdiction. *See Alcoa, Inc. et al. v. Bonneville Power Administration*, Nos. 99-71188 & 99-71189 (dismissal order filed February 9, 2000); *Goldendale Aluminum Co. et al. v. Bonneville Power Administration*, Nos. 99-70268 *et seq.* (dismissal order filed February 9, 2000); *Vanalco Inc. et al. v. Bonneville Power Administration*, No. 99-36213 & 00-35009 (dismissal order filed February 9, 2000, noting that "the questions raised in these appeals are so insubstantial as not to need further argument."). Alcoa and Vanalco have raised a number of constitutional and statutory objections to the Compromise Approach proposal. Each of these objections is discussed below.

15.5.2 Constitutional Issues

Issue 1

Whether the Compromise Approach unlawfully infringes on Alcoa's and Vanalco's First Amendment rights to petition the government for a redress of grievances.

Parties' Positions

Alcoa and Vanalco allege the Compromise Approach violates the Petition Clause of the First Amendment to the U.S. Constitution. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 5. According to Alcoa and Vanalco:

[T]he Petition Clause guarantees Alcoa's and Vanalco's right to make their views known to the BPA on the general subject of BPA's proposed rate-making proposals. BPA's Compromise Agreement unconstitutionally burdens the exercise of this right. Alcoa and Vanalco must pay (or are threatened with paying) a higher rate and receive (or are threatened with receiving) a smaller allocation of power than the companies who succumbed to the Compromise Agreement.

Id. at 6.

The case most heavily relied on by Alcoa and Vanalco in their initial brief in support of their argument is *Acevedo v. Surles*, 778 F. Supp. 179 (SDNY 1991). Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 6-7. According to Alcoa and Vanalco, the Compromise Approach, similar to the agency practice at issue in *Acevedo*, "had the effect of chilling" their First Amendment rights by imposing a "surcharge" for exercising those rights. *Id.*

Further, in their initial brief, Alcoa and Vanalco contend that:

[T]he Compromise Agreement conditions a benefit upon relinquishment of First Amendment rights. In exchange for preferential power and rates treatment, the Compromisers have agreed to content restrictions on their speech and to not fully participate in the rate-making process, including judicial review, as they otherwise would. Unquestionably the preferential treatment is a benefit, and its quid pro quo a relinquishment of First Amendment rights. The Compromisers consent to the relinquishment of First Amendment rights does not cure the First Amendment violation . . . The Compromise Agreements subvert the congressionally mandated public process. Indeed, silencing the DSIs is precisely BPA's intent, although BPA may choose different words of description.

Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 7-8.

In their brief on exceptions, Alcoa and Vanalco continue the same line of argument, asserting that BPA violated their First Amendment rights "to participate in this rate case on all issues, without being penalized through the smaller allocation and higher rates they suffer for refusing the silence required by the Compromise Approach." Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 47. Moreover, they downplay the significance of *Acevedo v. Surles*, *supra*, stating that it is simply "a single district court decision." *Id.* at 51. Instead, they state that their case rests on more "well known jurisprudence" established in numerous cases by the U.S. Supreme Court. *Id.*

BPA's Position

Given the strictly legal nature of Alcoa's constitutional arguments, BPA witnesses did not address this issue of whether the Compromise Approach infringed on Alcoa's and Vanalco's First Amendment rights.

Evaluation of Positions

BPA strongly disagrees with Alcoa's and Vanalco's arguments and conclusions. BPA believes that *Acevedo v. Surlis*, as well as the Supreme Court cases cited by Alcoa and Vanalco, are inapposite. Indeed, *Acevedo* provides an illuminating example of a meritorious First Amendment claim as opposed to the kind of claims raised by Alcoa and Vanalco.

In *Acevedo*, indigent hospital patients faced the prospect of losing medical benefits for necessary hospital care if they filed a claim, in court, against the state hospital that provided the care. The Court noted that "after a patient files a claim against the State in the New York Court of Claims, the [hospital] will serve a verified claim against the patient in which the patient is assessed full charges for the hospitalization and treatment received." 778 F. Supp. at 182. As a consequence, a patient filing a claim for approximately \$2,000 could be met with a counterclaim by the hospital exceeding \$100,000. *Id.* at 185. The Court found this penalty "chilled" the plaintiff's First Amendment rights to seek redress in the courts. Rather than supporting Alcoa's argument, *Acevedo* provides a striking contrast.

First, and perhaps most importantly, neither Vanalco nor Alcoa is a signatory to the Compromise Approach proposal. As such, they are not restricted in any manner by the Compromise Approach from pursuing relief in any forum (with jurisdiction) against BPA. None of their First Amendment rights to petition the government has been impacted by the Compromise Approach proposal. In contrast, the First Amendment rights of the indigent hospital patients were directly at issue in *Acevedo*.

Second, the indigent hospital patients in *Acevedo* did not have a full evidentiary administrative forum, presided over by a hearing officer, available to them to argue against the imposition of any penalty or charge. In fact, they had virtually no forum available to them at all. In this case, Alcoa and Vanalco had every opportunity to present their case in the ongoing rate case prior to any "penalty" being adopted, assessed, or imposed.

Third, the Compromise Approach proposal was a proposal arrived at voluntarily. The DSIs that elected to participate in the Compromise Approach proposal did so because it was presumably in their business interests to do so. Alcoa and Vanalco elected to opt out. That was their choice. No such choice was available to the plaintiffs in *Acevedo*.

Fourth, there was no penalty imposed or assessed against Alcoa and Vanalco under the Compromise Approach. Any differences in the terms or conditions of service that may exist between the DSIs that signed the Compromise Approach, as opposed to those that did not (Alcoa and Vanalco), is based on and justified by testimony filed by BPA in the instant rate proceeding. Indeed, as demonstrated in BPA's testimony, BPA is offering to sell Alcoa and

Vanalco more than half of the power they are currently purchasing from BPA at a price of 25 mills/kWh, well below projected market power prices. Berwager *et al.*, WP-02-E-BPA-38, at 3; *see* ROD section 15.5.4, *infra*.

Fifth, post-2001, none of the DSIs, including Vanalco and Alcoa, has a statutory right to purchase power from BPA. Although BPA may elect to serve the DSIs, BPA is not obligated to do so. In section 5(g) of the Northwest Power Act, Congress required BPA, in 1981, to offer the DSIs 20-year power sales contracts. 16 U.S.C. §839e(g)(1). Once those contracts expire, BPA has the authority, but not the obligation, to offer the DSIs new power sales contracts. This issue is discussed more fully at section 15.5.3, *infra*. Accordingly, Vanalco and Alcoa have no right to any particular allocation of BPA power or any allocation at a particular price. In contrast, the indigent hospital patients in *Acevedo* had a right to subsidized medical treatment.

Sixth, the instant case involves commercial transactions with sophisticated purchasers. Indeed, Alcoa is one of the largest multinational aluminum companies in the world. Vanalco and Alcoa have extensive resources at their disposal and the ability to make fully informed decisions with the support of the best attorneys, consultants, and experts available. The indigent hospital patients in *Acevedo* were hardly in a similar position.

The bottom line is that *Acevedo* provides no support for Alcoa's and Vanalco's allegations that their First Amendment rights to petition the government have been violated. Other cases cited by Alcoa and Vanalco are equally deficient and readily distinguishable. For instance, in their brief on exceptions, Alcoa and Vanalco quote passages from various cases from the U.S. Supreme Court. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 47-51. For the most part, the quoted portions of these cases simply recite black letter law regarding the importance and sanctity of the First Amendment. No one disagrees with these fundamental tenets. However, Alcoa and Vanalco fail to provide any nexus between the facts and holdings of those cases and the facts of this case. Moreover, none of these cases involves entities such as Alcoa and Vanalco attempting to assert First Amendment rights of behalf of an unaffiliated third party, especially where that third party is a competitor in business.

A case in point is *Eastern R. Pres. Conf. v. Noerr Motor Freight, Inc.*, which Alcoa and Vanalco describe as “[t]he leading Supreme Court case, and one of the few descriptive of the right of petition.” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 47. Alcoa and Vanalco state that *Noerr* “asserts the principle that guides one here: ‘[t]he right of petition is one of the freedoms protected by the Bill of Rights, and we cannot, of course, lightly impute to Congress an intent to invade these freedoms.’” *Id.* at 48. No one disagrees. The point, however, is that *Noerr* involved the scope of the Sherman Antitrust Act and whether Congress intended to prohibit certain political activity, as opposed to business activity, through that law. The Supreme Court refused to “lightly impute” to Congress an intent to restrict First Amendment political activity. The instant case has nothing to do with an interpretation of the Sherman Act or imputing any intent to Congress under any other statute.

Alcoa and Vanalco argue that “[t]his matter is also controlled by *Board of City Comm’rs v. Umbehr*,” which they contend “clearly rejects ‘unconstitutional conditions on speech.’” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 50. That argument, of course, assumes the

precise issue in dispute. Nevertheless, the issue before the Court in *Umbehr* was “whether, and to what extent, independent contractors are protected by the First Amendment,” and in particular “whether, and to what extent, the First Amendment restricts the freedom of federal, state or local governments to terminate their relationships with independent contractors because of the contractors’ speech.” 518 U.S. at 673, 673-74. The instant case, of course, involves nothing of the kind. It involves voluntary decisions by parties other than Alcoa and Vanalco to agree to a preliminary proposal for purposes of an administrative hearing.

Moreover, the fact that Alcoa and Vanalco have suffered no restrictions on their right to petition the government is highlighted by their own arguments. Attached to their brief on exceptions is testimony filed by Alcoa before Congress on April 6, 2000. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, Ex. A, at 7-12. In that testimony, Mr. Jack Speer, Northwest Energy Leader for Alcoa, addressed a U.S. House of Representatives Subcommittee on Water and Power. *Id.* The subject of the hearing was BPA’s Subscription process. *Id.* at 5. In his testimony, Mr. Speer advised Congress of Alcoa’s views on BPA’s proposal for service to the DSIs as well as his views on BPA’s proposed service to other BPA customers. *Id.* at 7-12. Indeed, Mr. Speer’s testimony addresses many of the same issues Alcoa and Vanalco complain of in this rate proceeding, including reduced service to the DSIs. *Id.* at 7-8 (“[w]here Bonneville used to supply about 95 percent of Northwest aluminum load, it is now offering to supply only 40-50 percent of the industry’s needs, and some of that power will be priced at market rates instead of traditional rates based on the cost of federal generation resources”). As such, Alcoa’s and Vanalco’s brief contradicts their own argument that their First Amendment rights to petition the government have been impaired by the Compromise Approach.

Lastly, Alcoa and Vanalco argue that “the Compromise Agreements subvert the congressionally mandated public process. Indeed, silencing the DSIs is precisely BPA’s intent . . .” Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 8. Contrary to this allegation, and as demonstrated above, it is clear that Alcoa and Vanalco have not been “silenced” in any manner. Moreover, the DSIs that signed the Compromise Approach proposal, as well as Alcoa and Vanalco, actively participated in the rates hearing through the presentation of a huge volume of testimony on a wide variety of issues. *See e.g.*, Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-02; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-03; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-04; WP-02-E-DS/AL/VN-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06; Adams, WP-02-E-DS-01; Wilcox *et al.*, WP-02-E-DS-02; Schoenbeck *et al.*, WP-02-E-DS-03; Adams, WP-02-E-DS-04; Waddington, WP-02-E-DS-05; Schoenbeck *et al.*, WP-02-E-DS-06.

Indeed, much of the testimony submitted by the “Compromising DSIs” was submitted as joint testimony with Alcoa and Vanalco. *See e.g.*, Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-02; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-03; Schoenbeck *et al.*, WP-2-DS/AL/VN-04; WP-02-E-DS/AL/VN-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06. As noted in BPA’s testimony, “[i]t is not true that the DSIs are foreclosed by the Compromise Agreement from further discussion of DSI issues. This should be abundantly clear from the volume of testimony on DSI issues filed by the DSIs that did sign the Compromise Approach.” Berwager *et al.*, WP-02-E-BPA-38, at 9.

It may be that Alcoa and Vanalco believe “the Compromise Approach atomized the DSIs, marginalized Alcoa and Vanalco, and interrupted the historical unity of the DSIs.” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 54, n. 2. And, it may be that Alcoa and Vanalco believe they lost political and legal clout as a consequence of the Compromise Approach proposal. However, if the “historical unity” of the DSIs was as intact as Alcoa and Vanalco claim, then presumably all the DSIs would have accepted or rejected the Compromise Approach proposal. The fact that most accepted, while Alcoa and Vanalco did not, indicates the alleged unity was already fractured.

From BPA’s perspective, the Compromise Approach was a good faith effort to reduce contention and litigation in the rate proceeding by developing an initial rate proposal that had support from the customers most directly affected by it--the DSIs. It evolved out of a series of meetings with the DSIs and was widely endorsed by the DSIs, including Alcoa, as an improvement over alternative DSI service proposals. *See, supra*, section 15.5.1. There is nothing in section 7(i) of the Northwest Power Act suggesting that a BPA rate proceeding must necessarily be divisive, litigious, and acrimonious. BPA does not believe it “subverts” the section 7(i) process or the First Amendment by attempting to reduce contention rather than enhance it.

Decision

BPA has not violated the First Amendment rights of Alcoa and Vanalco to petition the government for a redress of grievances.

Issue 2

Whether the Compromise Approach violates Alcoa’s and Vanalco’s First Amendment rights of assembly.

Parties’ Position

Alcoa and Vanalco argue that their First Amendment rights to assemble with other DSIs have been violated by the Compromise Approach. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 8. According to Vanalco and Alcoa, “the Assembly Clause protects the rights of persons to join together to seek favorable action from an administrative agency.” *Id.* In their initial brief, Alcoa and Vanalco allege that:

[T]he Compromisers, of course, have no constitutional obligation to assemble with Alcoa and Vanalco to petition BPA. They may not, however, choose not to associate as part of an agreement with BPA which itself violates the First Amendment. Based on their traditional positions, the Compromisers would likely be joining in with Alcoa and Vanalco on many issues that they have been silent about in their rate case testimony.

Id.

In their brief on exceptions, Alcoa and Vanalco expand on this point, arguing that their First Amendment rights include the rights to lobby Congress and participate in the rate case “as a cohesive group with all DSIs.” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 47. They further contend that *their* rights include the rights “of the Compromise DSIs to speak freely on all rate case issues, in the courts, and before Congress.” *Id.* Alcoa and Vanalco state that “the Compromise Approach violates the First Amendment speech and assembly rights of the Compromise DSIs and that Alcoa and Vanalco have standing to assert these rights.” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 56; *id.* at 54.

BPA’s Position

Given the strictly legal nature of Alcoa’s constitutional arguments, BPA witnesses did not address this issue of whether the Compromise Approach infringed on Alcoa’s and Vanalco’s First Amendment rights of assembly.

Evaluation of Positions

The Compromise Approach says nothing about the DSIs associating, or not associating, with one another. Each DSI is free to assemble with whomever it chooses. By agreeing to the Compromise Approach proposal, the “Compromising DSIs” elected not to challenge certain aspects of BPA’s rate proposal. That was their choice and their prerogative. Alcoa and Vanalco, in contrast, elected to reject the Compromise Approach and challenge every aspect of BPA’s rate proposal in every available forum. That is their choice and their prerogative. As a result, the “Compromising DSIs” and the “non-Compromising DSIs” made different business decisions with different consequences. The fact that these parties may have some differing interests and may elect to “associate” with each other on some issues but not “associate” on others, hardly rises to a constitutional level. Indeed, as noted above, Alcoa and Vanalco “associated” with the “Compromising DSIs” by sponsoring joint testimony on a wide spectrum of rate case issues. *See e.g.*, Adams, WP-02-E-DS-01; Wilcox and Waddington, WP-02-E-DS-02; Schoenbeck and Bliven, WP-02-E-DS-03; Adams, WP-02-E-DS-04; Waddington, WP-02-E-DS-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-02; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-03; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-04; WP-02-E-DS/AL/VN-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06.

In their brief on exceptions, Alcoa and Vanalco expressly state that they have standing to assert the First Amendment rights of the DSIs that signed the Compromise Approach proposal. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 54, 56. Alcoa and Vanalco fail to cite any authority that supports this proposition. Rather, they simply say “[s]ee the response to Section 15.5.1.” *Id.* However, Alcoa and Vanalco do not appear to make a standing argument in that section of their brief. The only case in that section that appears to directly address the issue of standing and the First Amendment is *NAACP v. Alabama*, 357 U.S. 449 (1958). *Id.* at 48. That case, however, is wholly distinguishable.

The issue in *NAACP* was whether the courts of Alabama properly held the NAACP in contempt of court for refusing to fully disclose the names of its members. Disclosure of the identity of NAACP members would have had severe repercussions on those individuals, including

“economic reprisal, loss of employment, [and] the threat of physical coercion.” 357 U.S. at 462. The NAACP asserted its right and standing to act on behalf of its members, and the Supreme Court agreed. 357 U.S. at 458. The Court stated that:

The Association [NAACP] both urges that it is constitutionally entitled to resist official inquiry into its membership lists, and that it may assert on behalf of its members, a right personal to them to be protected from compelled disclosure by the State of their affiliation with the Association as revealed by the membership lists. We think that petitioner argues more appropriately the rights of its members, and that its nexus with them is sufficient to permit that it act as their representative before this Court. In so concluding, we reject respondent’s argument that the Association lacks standing to assert here constitutional rights pertaining to the members, who are not of course parties to the litigation.

Id. at 458-459.

If *NAACP* is the basis for Alcoa’s and Vanalco’s standing argument, their argument is frivolous. The legal and factual distinctions between *NAACP* and the instant case are striking. Suffice it to say that Alcoa and Vanalco are not representatives of any other DSIs and have no rights to act on behalf of any other DSIs.

Moreover, contrary to Alcoa’s and Vanalco’s arguments, the Supreme Court stated in *NAACP* that it “has generally insisted that parties rely only on constitutional rights *which are personal to themselves*.” *Id.* at 459 (emphasis added). Alcoa’s and Vanalco’s argument that it has standing to assert constitutional rights of the “Compromising DSIs” squarely contradicts this rule.

Alcoa and Vanalco attempt to portray all the DSIs as a single homogenous group. That portrayal is false. Contrary to their representation, many of the DSIs directly compete against one another. As a result, Alcoa appears to be using the First Amendment as a vehicle to challenge an agreement voluntarily entered into by its competitors, and to contend that it has standing to do so. There is no First Amendment law cited by Alcoa and Vanalco to support this kind of practice. On the contrary, the only law cited by Alcoa and Vanalco rejects their argument.

Similarly, Alcoa and Vanalco argue that, “based on their traditional positions the Compromisers would likely be joining in with Alcoa and Vanalco on many issues they have been silent about in their rate case testimony.” Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 8. This argument is highly speculative. Given the era of energy deregulation, traditional alliances have undergone considerable change. The very fact that the “Compromising DSIs” accepted the Compromise Approach proposal, whereas Vanalco and Alcoa did not, demonstrates that a divergence of interests already exists between these various DSIs.

For instance, under the Compromise Approach proposal, the amount of power each DSI would be allocated is based on the amount of cost-based IP purchases made by each DSI in FY 1997-2001. Berwager *et al.*, WP-02-E-BPA-09, Attachment 1, at 1. Those DSIs that purchased larger amounts of IP power from BPA during this time period, such as Reynolds Metals, would be entitled to larger amounts of IP power under the Compromise Approach

proposal than those DSIs that purchased smaller amounts of IP power. As a result, in a letter to BPA, Reynolds Metals stated it would support the Compromise Approach “*provided* the power is allocated among the DSIs in the manner proposed by BPA.” Cross-Examination Exhibit, WP-02-E-AL-32, at 3 (emphasis in original).

In contrast, Alcoa and Vanalco purchased relatively small amounts of IP power from BPA in FY 1997-2000. In a letter to BPA, Vanalco expressed dismay that under the Compromise Approach proposal, it would be eligible to purchase only “an amount of power between 0 and 7.5 average megawatts out of its total plant load of 235 megawatts.” Cross-Examination Exhibit, WP-02-E-AL-32, at 10. The reason is that, in 1996, Vanalco elected to reduce the amount of IP power it purchased from BPA under its power sales contract from 230 aMW to 10 aMW to purchase power from suppliers at market prices which, at the time, were generally below BPA’s cost based rates. *See, generally, Association of Public Agency Customers et al. v. Bonneville Power Administration*, 126 F. 3d 1158, 1176 (9th Cir. 1997) (“By the fall of 1995, competition for the DSIs’ business was fierce. Many were considering attractive offers from alternative suppliers to serve their loads at prices below BPA’s rates.”). Similarly, Alcoa was not satisfied with the allocation provision of the Compromise Approach proposal and noted that there “should be further discussion of the allocation method among companies.” *Id.* at 16.

During the course of the section 7(i) hearing, Alcoa and Vanalco have been able to fully and completely litigate their case, individually, in concert with each other, and in concert with the other DSIs. Neither the Northwest Power Act nor the First Amendment of the U.S. Constitution entitles them to any more.

Decision

Alcoa’s and Vanalco’s argument that their First Amendment rights to assembly have been violated by the Compromise Approach is without merit.

Issue 3

Whether “the Subscription ROD-Compromise Approach scheme” violates Alcoa’s and Vanalco’s rights to equal protection under the law.

Parties’ Position

Alcoa and Vanalco allege that “[t]hrough the Subscription ROD-Compromise Approach scheme, BPA has denied Alcoa and Vanalco equal protection under the laws. With no legitimate justification, BPA has offered lower power rates and a larger allocation of power to the DSIs who have submitted to the Subscription ROD-Compromise Approach scheme, than to those who have insisted upon asserting their rights to participate fully in the power rate case, namely Alcoa and Vanalco.” Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 8-9. Alcoa and Vanalco reiterate this argument in their brief on exceptions. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 56-57.

BPA's Position

Given the strictly legal nature of Alcoa's constitutional arguments, BPA witnesses did not address this issue of whether the Compromise Approach infringed on Alcoa's and Vanalco's equal protection rights.

Evaluation of Positions

Alcoa and Vanalco offer no explanation of how their allegations translate into an equal protection issue. If their claim is that BPA failed to justify the proposed rate disparity between the DSIs that executed the Compromise Approach and those that did not (Alcoa and Vanalco), that justification is set forth in section 15.5.4, *infra*. Alcoa and Vanalco offer no support for their argument that a proposed rate disparity rises to the level of an equal protection violation.

Alcoa and Vanalco claim that BPA proposed a more "onerous" service arrangement upon them as opposed to the "Compromising DSIs" because they refused to accede to the Compromise Approach. Speer *et al.*, WP-02-E-AL/VN/EG-01, at 4. BPA witnesses contradicted this allegation, stating:

[W]e disagree with Alcoa's and Vanalco's characterization of BPA's proposal for service to them as 'onerous.' BPA is offering to sell Alcoa and Vanalco more than half of the power they are currently purchasing from BPA at a price of 25 mills/kilowatt-hour (kWh), well below projected market power prices. See Oliver *et al.*, WP-02-E-BPA-45. Second, Alcoa and Vanalco represented to BPA in negotiations that they were not interested in BPA power at either 23.5 or 25 mills/kWh, with or without the condition under the Compromise Approach, so it is unclear how the one proposal is 'onerous' compared to the other. Third, when Alcoa and Vanalco refused to join the other DSIs in signing the Compromise Approach, BPA could have opted to offer nothing to those two companies, or leave the original offer of their share of 1,200 average megawatts (aMW) at 25 mills/kWh on the table. In an attempt to demonstrate that there was no intent to unduly disadvantage Alcoa and Vanalco for their decision, BPA decided to carry the earlier below-market proposal to them into the initial proposal, so again we do not agree that proposing to make available to these two companies the original offer is 'onerous' compared with the alternative.

Berwager *et al.*, WP-02-E-BPA-38, at 3-4.

Lastly, Alcoa's and Vanalco's reference to a "Subscription ROD-Compromise Approach scheme" distorts and mischaracterizes BPA's actions. There was never a "scheme" to do anything. Rather, in the Subscription Strategy ROD, BPA stated that it expected to serve the entire DSI load. Months later, it was becoming less probable that such service could be provided. As noted in BPA's testimony:

The Subscription Strategy committed no specific amount of service to the DSIs. It stated that BPA's expectation was to serve all DSI loads that individual

companies asked BPA to meet. At the time the Subscription Strategy was developed, BPA expected to have sufficient inventory to meet DSI loads even after meeting other customer's [sic] Subscription requests with higher priority than DSI requests. Such an outcome now seems improbable given the high level of load projected to be placed on BPA by other customers.

Berwager *et al.*, WP-02-E-BPA-09, at 5-6.

In the Compromise Approach proposal, BPA, in cooperation with the DSIs, developed a proposal for service to the DSIs which included a proposed rate and proposed power allocation. Under this proposal, the DSIs would be eligible to receive "a flat block of power that is about 75 percent of what they are currently buying" at a rate of 23.5 mills/kWh, which is well below prevailing market rates. Berwager *et al.*, WP-02-E-BPA-09, at 2. This proposal was well received by the majority of DSIs, including Alcoa. Cross-Examination Exhibit, WP-02-E-AL-32, at 16. Indeed, correspondence from the "Compromising DSIs" reflects their support for and appreciation of the Compromise Approach proposal. *See* section 15.5.1, *supra*.

As a result, contrary to Alcoa's and Vanalco's allegations, the Compromise Approach is viewed by BPA as a favorable and generous proposal for service to the DSIs. This is especially true given that BPA and many customers and constituents in the region believe the sale of power to the DSIs post-2001 is purely discretionary. *See infra*, at 15.5.3. BPA has made a dedicated effort in the Compromise Approach proposal and in this rate proceeding to address an issue that was left unresolved at the time the Subscription Strategy ROD was issued, and to craft a proposal that was favorable to the DSIs without imposing undue costs on other BPA customers.

Decision

Alcoa's and Vanalco's claims that they have been deprived of equal protection under the law are without merit.

Issue 4

Whether Alcoa and Vanalco have been deprived of due process of law through the "Subscription ROD-Compromise Approach scheme."

Parties' Positions

Alcoa and Vanalco allege that "[t]hrough the Subscription ROD-Compromise Approach scheme, BPA has denied Alcoa and Vanalco due process of law" because: (1) they have been "denied their right under section 7(i) to a full rate hearing that permits all DSIs to fully participate"; (2) "Alcoa and Vanalco have been denied their right to have power within the class of DSIs to be equitably allocated . . ."; and (3) "the distinctions in power rates and power allocations between companies who submitted to the scheme and those who have not (Alcoa and Vanalco) are arbitrary, capricious, and an abuse of discretion which also violates §7(i) and the Administrative Procedures Act. . . ." Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 9. Alcoa and Vanalco

reiterate these arguments in their brief on exceptions. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 58-59.

BPA's Position

Given the strictly legal nature of Alcoa's constitutional arguments, BPA witnesses did not address the issue of whether the Compromise Approach infringed on Alcoa's and Vanalco's rights to due process.

Evaluation of Positions

Alcoa and Vanalco contend that they have been deprived of their rights to a full rate hearing that permits all DSIs to fully participate. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 9. Section 7(i) of the Northwest Power Act does not impose a minimum standard of participation on any DSI or on any other party. Each party to a BPA rate proceeding has the right to make its own determination regarding the level of its participation. A party can fully participate, partially participate, or not participate at all.

As noted *supra*, the DSIs that signed the Compromise Approach proposal actively participated in the rates hearing through the presentation of a huge volume of testimony on a wide variety of issues. See Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-02; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-03; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-04; WP-02-E-DS/AL/VN-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06; Adams, WP-02-E-DS-01; Wilcox *et al.*, WP-02-E-DS-02; Schoenbeck *et al.*, WP-02-E-DS-03; Adams, WP-02-E-DS-04; Waddington, WP-02-E-DS-05; Schoenbeck *et al.*, WP-02-E-DS-06. Indeed, much of the testimony submitted by Alcoa and Vanalco was submitted jointly with the "Compromising DSIs." See Schoenbeck *et al.*, WP-02-E-DS/AL/VN-01; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-02; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-03; Schoenbeck *et al.*, WP-2-DS/AL/VN-04; WP-02-E-DS/AL/VN-05; Schoenbeck *et al.*, WP-02-E-DS/AL/VN-06.

The fact that the "Compromising DSIs" did not challenge the Compromise Approach proposal is inconsequential. They simply elected to address issues which they found objectionable, and not address issues that were not objectionable. The "Compromising DSIs" determined at the outset of the proceeding that the Compromise Approach proposal was favorable and therefore not objectionable. Indeed, the Compromise Approach proposal was a proposal they helped develop and uniformly endorsed. "Those DSIs that agreed to the Compromise Approach did so partly on the basis that the service offered was an acceptable improvement, both in terms of price and amount, over what BPA had stated it was willing to offer them absent their agreement." Berwager *et al.*, WP-02-E-BPA-38, at 5-6. There is no impropriety to this approach, and certainly nothing which offends due process.

Alcoa's other issues are addressed in other sections of this ROD. In particular, the issues of whether power has been "equitably allocated" within the class of DSIs, and whether BPA's distinctions in power rates and allocations are arbitrary, can be found in sections 15.5.4 and 15.5.5, *infra*.

Decision

Alcoa's and Vanalco's claims that they have been denied due process of law are rejected.

Issue 5

Whether the Compromise Approach violates the integrity of the section 7(i) process.

Parties' Positions

Alcoa and Vanalco assert that the Compromise Approach violates “the integrity of the section §7(i) process.” Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 10. They allege that BPA, through the Compromise Approach, has violated the section 7(i) requirements to develop a “full and complete record,” and to provide “an adequate opportunity for any person ‘to offer refutation or rebuttal of any material submitted by any other person or by the Administrator.’” *Id.* at 10-11. In their initial brief, Alcoa and Vanalco state that, while they “remain ‘free’ to rebut the Administrator’s proposal, the Compromise Agreement silences those DSIs that accepted it on important rate case issues.” *Id.* at 11.

In their brief on exceptions, Alcoa and Vanalco reiterate many of these arguments. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 59-63. They argue, among other things, that “[i]f a party is not afforded a right to rebut BPA’s direct case, then the rebuttal record will not be ‘full and complete’ as required by §7(i).” *Id.* at 61. They further argue that “[b]y reason of the Compromise Approach, the Compromise DSIs had no opportunity to rebut BPA’s proposed decision.” *Id.*

In addition, Alcoa and Vanalco allege at numerous times that BPA prejudged the outcome of the rate case. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 2, 61-63, 111. In its initial brief, Alcoa and Vanalco allege “BPA effectively has decided in the Compromise Agreement several important factual issues, including the total amount of firm power available to the DSIs, the basis for allocating cost based power among the DSIs, the relative percentages of cost based power and market based power available to DSIs acquiescing to the Compromise Agreement.” Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 11. In their brief on exceptions, Alcoa and Vanalco state “the §7(i) process has been violated because the Administrator conducted this rate case with a closed mind.” Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-02, at 61. Alcoa and Vanalco allege that BPA decided factual issues related to the Compromise Approach prior to the rate case and outside the scope of the section 7(i) process. *Id.* at 2, 62-63.

BPA's Position

The arguments by Alcoa and Vanalco that BPA violated section 7(i) are substantially the same as their arguments that BPA infringed on their constitutional rights to petition the government for redress, rights to assembly, rights to equal protection, and rights to due process of law. It is for these reasons that Alcoa and Vanalco contend that the integrity of the section 7(i) process has been violated.

BPA witnesses expressly contradicted allegations by Alcoa and Vanalco that were specifically directed towards questioning the integrity of the section 7(i) process. For example, in response to allegations by Alcoa and Vanalco that, through the Compromise Approach, BPA made a “final decision” regarding rates for service to the DSIs, BPA witnesses stated that “no final decisions regarding service to the DSIs, including Vanalco or Alcoa,” had been made. Berwager *et al.*, WP-02-E-BPA-38, at 7. Similarly, BPA witnesses clearly stated that the Compromise Approach was an agreement by BPA to propose and support an initial rate proposal but remained subject to change in the rate case. Berwager *et al.*, WP-02-E-BPA-38, at 8. In a sworn declaration filed in Federal court, BPA Administrator Judith Johansen refuted Alcoa’s and Vanalco’s allegations that she predecided the outcome of the rate case. Speer *et al.*, WP-02-E-AL/VN/EG-02, at 2.

Evaluation of Positions

Given that the arguments by Alcoa and Vanalco that BPA violated section 7(i) are substantially the same as their arguments that BPA infringed on their constitutional rights, BPA incorporates by reference into this section its responses to Alcoa’s and Vanalco’s constitutional arguments, set forth above.

In addition, from BPA’s perspective, the fact that the “Compromising DSIs” elected not to challenge the Compromise Approach is irrelevant to whether the record is “full and complete.” Each party to the rate proceeding is free to make its own decisions regarding which issues to challenge. Each of the DSIs, including Alcoa and Vanalco, had the choice to accept or reject the Compromise Approach proposal. By accepting the Compromise Approach, the “Compromising DSIs” made a decision at the outset of the proceeding that they had more to gain by agreeing with the Compromise Approach proposal than by arguing various DSI service alternatives in the rate case. The record reflects the fact that the majority of DSIs found the Compromise Approach proposal acceptable, and that Alcoa and Vanalco did not.

Alcoa’s and Vanalco’s argument that BPA pre-judged the outcome of the rate case is equally misguided. The Compromise Approach was part of BPA’s initial proposal for purposes of the rate case, and was treated the same as any other aspect of BPA’s initial proposal. BPA did not predecide the outcome of this issue, or any other issue in this proceeding. As noted in BPA’s rebuttal testimony:

The Compromise Approach is an agreement by BPA to propose and support an Initial Proposal consistent with the Compromise Approach, but the proposal is subject to change in the rate case. BPA often fashions both the outlines and the details of rate case proposals with its customers prior to the commencement of a rate case, for example, through its rate case workshops. This is not unusual and in fact is appropriate. BPA tries to formulate rate proposals that it believes will be largely acceptable to its customers, and such proposals can only be formulated through negotiation and compromise with its various classes of customers.

Berwager *et al.*, WP-02-E-BPA-38, at 8.

In lawsuits filed by Alcoa and Vanalco in Federal court, Alcoa and Vanalco argued, as they do here, that BPA predecided the outcome of the rate proceeding. *See Alcoa, Inc. et al. v. Bonneville Power Administration*, Nos. 99-71188 & 99-71189 (dismissed February 9, 2000). In response, BPA produced a sworn Declaration of Judith Johansen, BPA Administrator. In her sworn Declaration, Administrator Johansen states:

I have made no final decisions regarding the rate for power to be sold to Bonneville's direct service industrial customers, including Alcoa or Vanalco, or the amount of power that would be allocated to Bonneville's direct service industrial customers, including Alcoa or Vanalco. Similarly, I have made no final decisions that result in Alcoa or Vanalco paying a higher rate for power, or receiving a smaller allocation of power, than the direct service industrial customers that signed the document referred to as the "Compromise Approach."

See Speer, et al., WP-02-E-AL/VN/EG-02, at 2.

BPA believes this sworn declaration squarely refutes Alcoa's and Vanalco's allegations that BPA prejudged the outcome of the rate case.

Decision

BPA did not violate the integrity of section 7(i) of the Northwest Power Act or predecide the outcome of any aspect of the rate proceeding.

15.5.3 Obligation To Serve

Issue

Whether BPA has a statutory obligation to serve DSI load after September 30, 2001.

Parties' Positions

Alcoa and Vanalco argue that BPA has a continuing obligation to serve the DSIs after the 1981 contracts, or their successors, expire on September 30, 2001, pursuant to the Pacific Northwest Consumer Power Preference Act of 1964, 16 U.S.C. §837-837(h) (Preference Act); the Northwest Power Act, 16 U.S.C. §839-839(h); and the Bonneville Project Act, 16 U.S.C. §832-832(m). Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 80-89. They argue that even if BPA has no statutory obligation to sell power to the DSIs, this does not mean that BPA, as an agency of the government, has the unfettered discretion to use any procedure it chooses to decide how or whether to allocate power to the DSIs. *Id.* at 80. They state that neither Alcoa nor Vanalco believed that their contribution "to pay for BPA's system from 1939 forward" would be disregarded, or that contrary to BPA statutes they would be denied the opportunity to share in the benefit of low-cost power provided by that system. *Id.* at 83.

Alcoa and Vanalco argue that the legislative history of the Regional Preference Act leaves "no doubt" that BPA must supply power to the DSIs before it may sell power out-of-region, and that

“protecting the DSIs” was a primary purpose of the Regional Preference Act. *Id.* at 84-85. They conclude that the Regional Preference Act requires that before BPA offers to sell any power outside the Northwest it must offer such power to the DSIs at cost-based rates, and that BPA’s intent to sell 1,164 aMW of power to out-of-region loads over the five-year rate period violates the Regional Preference Act because the “full requirements” of the DSIs will not be met first. *Id.* at 86, 88. Alcoa and Vanalco argue that BPA’s authority to acquire resources under section 6(b) of the Northwest Power Act, 16 U.S.C. §839d(b)(1), *et seq.*, taken together with the legislative history of that Act, indicating a “national interest” in continuing sales to the DSIs engaged in the smelting of nickel and aluminum, show that BPA “has no discretion to disobey Congress and stop selling power to the DSIs.” *Id.* at 89.

In their brief on exceptions, Alcoa and Vanalco appear to have copied the arguments largely verbatim from their initial brief, Alcoa/Vanalco Ex. Brief, WP-02-AL/VN-01, at 63-73; but also state that BPA appears to be arguing in the Draft ROD that their regional preference rights are limited to competing with out-of-region purchasers to buy power under the prevailing surplus power rate schedule. *Id.* at 71.

SUB argues that BPA should make a final determination regarding its statutory obligation to serve DSI load after September 30, 2001, because such sales impact the rates of other customers either directly or indirectly. SUB Ex. Brief, WP-02-R-SP-01, at 3.

BPA’s Position

For the rate period FY 2002-2006, BPA has proposed to serve up to approximately one-half of existing DSI plant load, or roughly 75 percent of current DSI load placed on BPA under the IP-96 power rate. Berwager *et al.*, WP-02-E-BPA-09, at 6. This proposal contemplates some amount of service under section 5(d)(1)(A) of the Northwest Power Act, 16 U.S.C. §839c(d)(1)(A)), to every DSI customer, including Alcoa and Vanalco. Therefore, the question whether BPA is obligated to continue directly serving DSI load after September 30, 2001, is not specifically at issue in this rate case. Nevertheless, a number of parties, including BPA, have stated in testimony or briefs that BPA does not have a statutory obligation to continue to directly serve DSI loads after expiration of the initial 1981 (or their successor 1996) power sales contracts when those contracts expire September 30, 2001. *See, e.g.*, Berwager *et al.*, BPA-02-E-BPA-38, at 5, 12 (section 5(d) obligation); PPC Brief, WP-02-B-PP-01, at 51; Cross *et al.*, WP-02-E-WA-01, at 7; SUB Brief, WP-02-B-SP-01, at 4; MAC Brief, WP-02-B-MA-01, at 8.

Also, the issue is relevant in the context of BPA’s proposal for service to Alcoa and Vanalco, specifically the amount of power allocated to those companies and the price at which BPA is proposing to sell that power. BPA’s proposals with respect to those two issues are supported, in part, by the discretionary as opposed to mandatory nature of BPA’s proposal to serve Alcoa and Vanalco. Therefore, BPA will state its position on the points raised by Alcoa and Vanalco on this issue, and evaluate the merits of the arguments presented by Alcoa and Vanalco, but a final decision on this issue in this rate case is neither necessary nor appropriate. It is not necessary since, as noted, BPA’s proposal contemplates service for at least some portion of load for every DSI customer. It is not appropriate since other customers, including the other DSIs, have not

briefed this question. In any case, Vanalco, on March 15, 2000, filed a petition with the Ninth Circuit Court of Appeals seeking review of BPA's refusal to sell Vanalco surplus firm power at the IP-96 rate, which Vanalco believes BPA must do under the Northwest Power Act and Regional Preference Act. Another DSI, Kaiser Aluminum and Chemical Corporation, filed a similar petition on April 4, 2000. Therefore, at least some of the issues raised here by Alcoa and Vanalco have already been set before the Ninth Circuit.

In addition, when Alcoa and Vanalco assert that BPA has an obligation to serve the DSIs, we assume they mean an obligation to directly serve DSI load under a power sales contract by and between BPA and the DSI, as opposed to some obligation to serve DSI load indirectly through sales to BPA's public utility customers, which raises separate and distinct issues that will not be addressed here.

With respect to the Northwest Power Act, it seems clear from both the plain language of that statute, and those pieces of legislative history from the Northwest Power Act that address this issue directly, that BPA has the authority, but not the obligation, to offer any DSI a follow-on contract under section 5(d)(1)(A) following the expiration of the initial section 5(d)(1)(B) contracts (initial contracts). Likewise, BPA does not agree with Alcoa and Vanalco that the Regional Preference Act of 1964 provides an independent source of an obligation by BPA to serve the full requirements of the DSIs at cost-based rates before making any out-of-region sales.

Evaluation of Positions

The argument by Alcoa and Vanalco that the Regional Preference Act and its legislative history "require BPA to serve the DSIs" at cost-based rates is incorrect. Alcoa and Vanalco appear to argue two points here: (1) that BPA has an obligation to meet the "full requirements" of Alcoa and Vanalco before making sales of power to any out-of-region customer; and (2) that the sale of such power to Alcoa and Vanalco must be at a "cost-based rate." Alcoa and Vanalco argue that "protecting the DSIs was a primary purpose of the Regional Preference Act." Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 85. The excerpts of legislative history cited by Alcoa and Vanalco do indicate Congress was concerned that the proposed new transmission intertie between the PNW and PSW not be used in a way that would be detrimental to "the electroprocess industries" and the jobs that industry sustained. *Id.* However, Alcoa and Vanalco stray from both the Regional Preference Act and any cited legislative history when they conclude that the Regional Preference Act requires BPA to meet the "full requirements" of any DSI "at cost-based rates" before selling any Federal power outside the PNW.

Section 1(c) of the Regional Preference Act defines "surplus energy" as

. . . electric energy generated at Federal hydroelectric plants in the PNW which would otherwise be wasted because of the lack of a market therefor in the PNW at any established rate.

16 U.S.C. §837(c).

Section 9(c) of the Northwest Power Act reiterated that sales of surplus power outside the region were subject to the notice and recall provisions of the Regional Preference Act, but also clarified the definition of surplus energy to mean:

. . . electric energy for which there is no market in the PNW at any rate established for the disposition of such energy . . .

16 U.S.C. §839f(c).

The language in section 9(c) made it clear that the phrase “any established rate” used in section 1(c) of the Regional Preference Act meant more precisely “any rate established for the disposition of such energy.” Section 5(f) of the Northwest Power Act authorizes the Administrator to market power that is surplus to her obligations to serve PNW customers under sections 5(b) (public customers), 5(c) (IOU), and section 5(d) (DSI customers). The rates for the “disposition of such energy” are established pursuant to section 7(f) of the Northwest Power Act. 16 U.S.C. §839e(f). Currently, the Firm Power Products and Services (FPS-96) rate schedule is the applicable schedule for such sales. In general, firm surplus power sales under FPS-96 are priced at negotiated rates that, while in the aggregate are projected to recover BPA’s costs, on a case-by-case basis are priced based on market conditions. *See* 1996 ROD, WP-96-A-02, at 60-65. This, then, is the “rate established for the disposition of such energy.” Alcoa and Vanalco argue the Regional Preference Act requires BPA to sell firm surplus power to them at some unspecified cost-based rate. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 85-86. To the extent that this is a reference to the Industrial Firm Power rate established pursuant to section 7(c)(2) of the Northwest Power Act, or to some rate other than the rate or rates established under section 7(f), BPA disagrees. The established rate for the firm surplus energy specified in sections 1(c) of the Regional Preference Act and section 9(c) of the Northwest Power Act would be any rate negotiated by BPA and the customer for the sale under the FPS-96 rate schedule.

Next, BPA does not agree with Alcoa and Vanalco that BPA, in fact, has an obligation at all times under the Regional Preference Act to meet their “full requirements” before making sales of power outside the region. BPA agrees that so long as Alcoa and Vanalco maintain a power sales contract with BPA, they remain a “PNW customer” of BPA. The Regional Preference Act specifies that the full requirements for electric energy of “any PNW customer” will take priority over sales outside the region. Absent a contract, Alcoa and Vanalco are not “customers” of BPA. “PNW customer” is defined at section 1(f) of the Regional Preference Act to include “any purchaser from the United States for direct consumption in the PNW.” 16 U.S.C. §837(f). At the time the Regional Preference Act was enacted, this would have included any industrial entity in the region, and contemplated the direct sale of Federal power by BPA to such entities. However, this broad definition was necessarily delimited by section 5(d)(2) of the Northwest Power Act, enacted on December 5, 1980, which prohibits the Administrator from selling power directly to new DSI customers. 16 U.S.C. §839c(d)(2). Therefore, the class of direct service industrial customers was limited to those industrial customers that had a contract for the purchase of power from BPA on December 5, 1980. *See* 16 U.S.C. §839c(d)(4)(A), (B). Arguably, Alcoa and Vanalco would lose this status, and their status as a “PNW customer” under the Regional Preference Act, if the Administrator elected not to offer them new contracts.

In addition, as noted above, section 5(f) of the Northwest Power Act authorizes the Administrator to:

. . . sell, or otherwise dispose of, electric power, including power acquired pursuant to this and other Acts, that is surplus to [her] obligations incurred pursuant to subsections (b), (c), and (d) of this section in accordance with this and other Acts applicable to the Administrator . . .

16 U.S.C. §839c(f).

Subsection (d) referred to in this passage is the provision authorizing sales by BPA to the DSIs. If there is no obligation to offer Alcoa and Vinalco a new power sales contract under section 5(d), then the Administrator has met her “obligations incurred pursuant to subsections (b), (c), and (d)” and Alcoa and Vinalco have no right to have their “full requirements” met before BPA may make sales outside the PNW. This is where the Regional Preference Act and the Northwest Power Act intersect: if there is no obligation to offer Alcoa and Vinalco a follow-on section 5(d) contract, then any power remaining after the Administrator has met her obligations under sections 5(b) and 5(c) is surplus, irrespective of the load status of Alcoa and Vinalco. Alcoa and Vinalco state in their brief on exceptions that BPA appeared to argue in the Draft ROD that their regional preference rights are to compete with out-of-region purchasers to buy power under the prevailing surplus power rate schedule. Alcoa/Vinalco Ex. Brief, WP-02-R-AL/VN-02, at 71. This is not correct. So long as Alcoa and Vinalco maintain their status as a “Pacific Northwest customer” under the Regional Preference Act, they will have preference to surplus power over out-of-region customers. However, as explained above, this power would be available under the prevailing surplus power rate schedule, not the Industrial Firm Power rate schedule. But even if Alcoa and Vinalco maintain their “customer” status under the Regional Preference Act, BPA disagrees that it is obligated to meet their “full requirements” before it may make any out-of-region sales, if by “full requirements” they mean their total plant load. If Alcoa and Vinalco do have new section 5(d) contracts, their regional preference rights are delimited by the total load amount served under that contract.

Turning to the Northwest Power Act, Alcoa and Vinalco argue that BPA is obligated to offer a new power sales contract to the DSIs because section 6(b) of the Northwest Power Act “created authority for BPA to augment the [Federal Base System] by purchasing power to enable sales to the DSIs.” Alcoa/Vinalco Brief, WP-02-B-AL/VN-01, at 89. They argue that this is made more clear by excerpts from the legislative history of that Act indicating that continued sales of power by BPA to the DSI smelters was in the national interest. *Id.* They dismiss as ambiguous the oft-cited passage from the legislative history of the Northwest Power Act that “subsequent contracts for these DSIs are authorized but not mandated,” but contend that this ambiguity is clarified in favor of an interpretation that Congress intended to mandate BPA service to the DSIs after September 30, 2001, by giving BPA its power purchasing authority, and by referring to continued service to the DSIs as in the “national interest.”

The statement from the House Report addressing the issue of follow-on contracts reads in full:

Section 5(d) authorizes the Administrator to sell power to existing direct service industrial customers that have a BPA contract at the date this bill is enacted. Initial long-term 20-year contracts are to be offered by BPA to these customers in accordance with section 5(g). In return for these new contracts, the DSIs would have to agree to terminate their current contracts. Subsequent contracts for these DSI's [sic] are authorized but not mandated."

H.R. Rep. No. 96-976, 96th Cong., 2d Sess., Pt. I at 61 (May 15, 1980).

While BPA considers this a dispositive statement of Congressional intent that follow-on DSI contracts are discretionary, it is not necessary to resort to this piece of legislative history to arrive at that conclusion. Section 5(d)(1)(A) states that "the Administrator is authorized" to sell power to the DSIs. Section 5(d)(1)(B) states that "the Administrator shall" offer the DSIs an initial long-term contract for an amount of power equivalent to that which the DSI was entitled to under its 1975 contract with BPA. The contrast is clear: one provision is mandatory, the other discretionary. If Congress had intended that follow-on contracts under section 5(d)(1)(A) be mandatory as well, it would have so stated.

In addition, there is nothing in section 6 of the Northwest Power Act (16 U.S.C. §839d(a)(1)) indicating that Congress intended that BPA must use its resource acquisition authority under that section to serve DSI load. In particular, section 6(a)(2)(A) only directs the Administrator to acquire sufficient resources to meet her contractual obligations. Alcoa and Vanalco have gotten ahead of themselves: absent a contract, the Administrator has no obligation to acquire resources to serve them. Furthermore, the conclusion that section 6 obligates the Administrator to make purchases to serve Alcoa and Vanalco is not consistent with section 5(b)(1) of the Northwest Power Act (16 U.S.C. §839c(b)(1)) which requires BPA to meet, when requested, the net firm power requirements of BPA's Northwest public body, cooperative, and IOU customers. If Congress had intended to mandate service by BPA to the DSIs after the termination of the initial long-term contract on September 30, 2001, it could have included the DSIs as a net-requirements customer under section 5(a)(1). Absent the status of a net-requirements customer, and the concomitant right to a net-requirements contract, the Administrator has no obligation to use her section 6 purchasing authority to serve Alcoa or Vanalco.

SUB argues that BPA should make a final determination regarding its statutory obligation to serve DSI load after September 30, 2001, because such sales impact the rates of other customers either directly or indirectly, and as such the issue has a direct bearing in this case. SUB Ex. Brief, WP-02-R-SP-01, at 3. SUB urges BPA to find it has no such obligation, particularly in the case where there is a request for service from a preference customer. *Id.* However, the direct or indirect impact on other customers occurs whether DSI sales are mandatory or discretionary, and since it is BPA's proposal to establish rates to make power available to serve some portion of each DSI's load in the next rate period, a final decision on whether that proposal is required by statute is not required. Also, BPA continues to believe making a final determination in the ROD on this issue would be unfair to those parties that have not briefed this issue, perhaps partly or completely in reliance on BPA's position that it would not make a final decision.

Decision

Because BPA's proposal contemplates service to meet some portion of each DSI customer's load, it is not necessary for BPA to make a final decision whether it has the statutory obligation under the Northwest Power Act to offer the DSIs new power sales contracts after September 30, 2001. Additionally, the issue of whether BPA is obligated under the Regional Preference Act of 1964 to meet the full requirements of a DSI customer at cost-based rates before BPA may make any sales out-of-region is the subject of a petition currently pending before the Ninth Circuit Court of Appeals.

15.5.4 Rate Directives

Issue 1

Whether BPA may charge Alcoa and Vanalco a slightly higher rate than the rate BPA is proposing to charge the DSIs that signed the Compromise Approach agreement.

Parties' Positions

Alcoa and Vanalco argue that BPA has provided no legitimate basis for discriminating between the proposed rate for the DSIs that signed the Compromise Approach agreement and the proposed rate for Alcoa and Vanalco. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 12. They argue that BPA cannot link the difference in the proposed rates to a corresponding differential in cost of service, and that this failure is in itself fatal to BPA's proposal. *Id.* Alcoa and Vanalco assert that the sole reason BPA is proposing a higher rate for them is that BPA wanted to "silence potentially vocal adversaries in both the rate case and the broader political arena" and that such silence could not be obtained unless there was a penalty for speaking. *Id.* at 13-14. They argue that section 7(g) of the Northwest Power Act (16 U.S.C. §839e(g)) obligates BPA to equitably allocate to power rates in accordance with generally accepted ratemaking principles all costs and benefits which are not otherwise allocated by the rate directives. *Id.* Alcoa and Vanalco reason that because the proposed IPTAC rates are not made pursuant to the specific rate directive applicable to DSI rates, that this allocation must conform to the requirements of section 7(g). *Id.* at 14.

Alcoa and Vanalco argue that regulated utilities generally may not unduly discriminate among similarly situated customers, citing section 205(b) of the Federal Power Act (16 U.S.C. §824d(b)). *Id.* They note that in addition to cost-of-service distinctions, the courts have also recognized other factual differences that will justify disparate rates for otherwise similarly situated customers, including the existence of fixed rate contracts and certain rate settlements, but that BPA's proposal met none of these tests. *Id.* at 14-16.

In their brief on exceptions Alcoa and Vanalco appear to repeat largely verbatim the arguments made in their initial brief. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, 73-80. However, Alcoa and Vanalco state that BPA has not explained why the costs associated with the 450 aMW of purchases to be made to serve DSI load are not being equitably allocated to all DSIs under section 7(g) of the Northwest Power Act. *Id.* at 76.

BPA's Position

BPA's proposal to charge Alcoa and Vanalco a slightly higher rate (25 mills/kWh) than the rate proposed for the DSIs that signed the Compromise Approach Agreement (23.5 mills/kWh) is fully justified under the factual circumstances and business framework in which the proposal was made and, in any case, there is no anti-discrimination standard applicable to this discretionary sale of power by the Administrator to the DSIs.

BPA's DSI service proposal evolved through negotiations with the DSIs that occurred after publication of the Subscription Strategy in December 1998. Berwager *et al.*, WP-02-E-BPA-09, at 15. BPA's initial position in these negotiations was that it could propose in the rate case to offer the DSIs approximately 1,200 aMW of service at a rate of 25 mills/kWh. *Id.* This proposal was referred to as the Targeted Augmentation Approach, because BPA would use \$25 million to augment its system and combine 500 aMW of power at approximately 21 mills/kWh with 700 aMW of market-priced power in order to provide the DSIs 1,200 aMW at a melded rate of 25 mills/kWh. *Id.* The DSIs indicated, however, that the Targeted Augmentation Approach proposal was inadequate to address the threat to continued smelter operations posed by low aluminum prices and rising market power prices. Tr. 272; Berwager *et al.*, WP-02-E-BPA-09, at 6. BPA subsequently enhanced the offer it would be willing to propose in the rate case to include 1,500 aMW of power at a rate of 23.5 mills/kWh, and this offer came to be known as the Compromise Approach. *Id.* at 15. However, BPA explained to the DSIs that it was unwilling to ask other customers to bear additional costs to provide this enhanced level of service unless the DSIs would commit to supporting the Compromise Approach, and informed them that failure to do so would result in BPA going forward with the Targeted Augmentation Approach. *Id.* at 14-15. Offering service at the slightly higher Targeted Augmentation Approach rate to Alcoa and Vanalco appropriately reflects the loss of value that BPA had hoped to receive from their support--and which it did receive from the other DSIs--and is consistent with the signals BPA sent during the negotiations. *Id.* at 17.

In any case, there is no antidiscrimination standard that applies to the rates proposed by the Administrator for these discretionary sales to the DSIs. As explained in the preceding issue, BPA believes it has no statutory obligation to offer Alcoa or Vanalco a new power sales contract under section 5(d) of the Northwest Power Act after September 30, 2001. Both the Targeted Augmentation Approach proposal and the Compromise Approach agreement proposal are negotiated, discretionary offers of power by the Administrator. As such, the Administrator is not obligated to offer, following such negotiations, the same terms and conditions, including the same rates, to every member of a class of customer to whom the Administrator has no obligation to serve in the first instance.

In addition, BPA does not agree that section 7(g) of the Northwest Power Act requires a different result, or that the anti-discrimination standards under the FPA, or the cases applying those standards, have any application to this proposal.

Evaluation of Positions

Alcoa and Vinalco are wrong to conclude there is no legitimate basis for the Administrator's proposal to offer them power at a higher rate than that offered to the DSIs that signed the Compromise Approach.

Alcoa and Vinalco first argue that absent a cost-of-service basis for the difference between the rates, that BPA must offer Alcoa and Vinalco the same rate offered to the other DSIs. Alcoa/Vinalco Brief, WP-02-B-AL/VN-01, at 12. Given the uncertainty about whether Alcoa and Vinalco would purchase from BPA even at 23.5 mills/kWh, there certainly is some part of the 1.5 mills/kWh difference between the two proposed rates that could be attributed to the cost and risk associated with planning to serve that load. Berwager *et al.*, WP-02-E-BPA-38, at 5-6. It is difficult to see how the letter from Alcoa to BPA regarding the Compromise Approach cited by Alcoa and Vinalco can be read to indicate that Alcoa would purchase any power from BPA at 23.5 mills/kWh, Alcoa/Vinalco Brief, WP-02-B-AL/VN-01, Attachment 2; so it seems reasonable to conclude that making augmenting purchases on behalf of these companies carries more risk than purchases made on behalf of companies supporting the proposal. However, whether BPA correctly interpreted these companies' purchase intentions is ultimately not important, because any cost risk associated with that uncertainty is not the primary reason there is a 1.5 mill/kWh difference between the proposed rates. In fact, the 1.5 mill/kWh difference between the rates is reflective of the difference between the Targeted Augmentation Approach and the Compromise Approach.

The Administrator was willing to make a proposal for service to the DSIs of 1,200 aMW at an average rate of 25 mills/kWh without any corresponding return of consideration from the DSIs. Berwager *et al.*, WP-02-E-BPA-09, at 16. This was the Targeted Augmentation Approach proposal. Further negotiations ensued after the DSIs indicated this proposal was inadequate to address the threat to continued smelter operations posed by low aluminum prices and rising market power prices. Tr. 272; Berwager *et al.*, WP-02-E-BPA-09, at 6. At that point, and in the context of a business negotiation, the Administrator determined that it was necessary to secure some level of consideration from the DSIs in return for an enhanced proposal. All the DSIs, except Alcoa and Vinalco, agreed to support the Compromise Approach agreement pursuant to the terms contained in a June 18, 1999, letter from BPA to each DSI customer. See Berwager *et al.*, WP-02-E-BPA-09, at Attachment 1.

In general, in exchange for the enhanced level of service offered in the Compromise Approach, the signing DSIs agreed: (1) to support the Compromise Approach in the rate case and in other venues; (2) not to legally challenge the Compromise Approach if it was substantially sustained in the rate case Final ROD, (3) not to challenge in the rate case BPA's proposal for the sale of power under the Subscription Strategy to the investor-owned utilities, or to file litigation challenging that proposal if the Compromise Approach was substantially sustained in the Final ROD (unless the Subscription Strategy proposal for service to the DSIs was challenged by certain parties); and 4) to argue to hold in abeyance pending litigation challenging the Subscription Strategy so long as BPA was supporting the Compromise Approach, and if the Compromise Approach was substantially sustained in the Final ROD, to withdraw that litigation

(unless the Subscription Strategy proposal for service to the DSIs was challenged by certain parties). *Id.*

In the framework of this arms-length negotiation, BPA determined it could not justify offering Alcoa and Vanalco the same terms of service offered to DSIs giving BPA this substantial consideration in exchange for the enhanced service proposal in the Compromise Approach agreement. Berwager *et al.*, WP-02-E-BPA-09, at 16. A commitment to support the Compromise Approach agreement would have little meaning or value to BPA, the DSIs that supported the proposal, or to other customers if the rate under the Compromise Approach was made available regardless of whether a DSI committed to supporting the proposal or agreed to the other consideration reflected in that agreement. *Id.* Service to Alcoa and Vanalco at a rate 1.5 mills/kWh higher than the rate offered to the other DSIs equals the difference between the penultimate offer embodied in the Targeted Augmentation Approach and the enhanced proposal in the Compromise Approach, reflects the loss of value that BPA had hoped to receive from their support, and is consistent with the signals that BPA sent during the negotiations. *Id.* at 17. When Alcoa and Vanalco declined to join the other DSIs in signing the Compromise Approach, BPA could have opted to offer these two companies nothing. In an attempt to demonstrate that there was no intent to unduly disadvantage Alcoa and Vanalco for their decision, BPA instead decided to carry into the rate case for them the original, and below-market, Targeted Augmentation Approach proposal. Berwager *et al.*, WP-02-E-BPA-38, at 3-4.

The Compromise Approach proposal represents a discretionary allocation of power by the Administrator to the DSIs under section 5(d) of the Northwest Power Act. 16 U.S.C. §5(d)(1)(A). Simply stated, the Administrator, exercising her ability to make discretionary sales to the DSIs, was giving value and expected, as a business proposition, to receive some value in return. Neither Alcoa nor Vanalco have a statutory right to a follow-on power sales contract under section 5(d)--at any rate. It is unreasonable for Alcoa and Vanalco to argue that the Administrator must propose to offer them the same allocation and rate enhancements proposed for the DSIs that signed the Compromise Approach agreement. The consequence of adopting this argument would be to greatly undermine, if not render completely impotent, the Administrator's bargaining power in cases such as this. Such a result is neither reasonable from a business perspective, nor required by the statutory provisions or ratemaking principles cited by Alcoa and Vanalco.

Alcoa and Vanalco next argue that section 7(g) of the Northwest Power Act (16 U.S.C. §839e(g)) obligates BPA to equitably allocate to power rates in accordance with generally accepted ratemaking principles all costs and benefits which are not otherwise allocated by the rate directives. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 13-14. Alcoa and Vanalco reason that because the proposed IPTAC rates are comprised of a combination of power priced under section 7(c)(2) of the Northwest Power Act and power priced at market rates, the allocation of these costs (market purchases) and benefits (power available at the section 7(c)(2) rate) is not made pursuant to the specific rate directive applicable to the DSIs, and therefore must conform to the requirements of section 7(g). *Id.* at 14. In the context of their assertion that the rate provisions do not contemplate different rates for similarly situated customers, Alcoa and Vanalco appear to argue that because only part of the power proposed to be allocated to the DSIs

(990 aMW of 1,440 aMW) is priced at the section 7(c)(2) rate, the costs of the entire amount must be allocated uniformly to the DSIs at a single rate pursuant to section 7(g).

In fact, the rates applicable to each component of the proposal--990 aMW at the 7(c)(2) rate of 20.98 mills/kWh and 450 aMW at the projected market rate of 28.1 mills/kWh--is the same for all DSIs, including Alcoa and Vanalco. However, the DSIs supporting the Compromise Approach have a higher percentage of their allocation (870 aMW or 72 percent) coming from this cost-based section 7(c)(2) portion than do Alcoa and Vanalco (120 aMW or 52 percent). Berwager *et al.*, WP-02-E-BPA-09, at 17. However, that fact has nothing to do with how the costs of the 990 aMW or the 450 aMW are allocated, but rather reflects the smaller allocation and slightly higher rate under the Targeted Augmentation Approach being made available to Alcoa and Vanalco. Conversely, Alcoa and Vanalco are also paying the same rate for their share of the 450 aMW as the other DSIs, but their allocation simply consists of a larger portion of this higher cost power. The issue is not so much how costs have been allocated under the rate directives, but rather how the Administrator has exercised her discretion in allocating benefits to the companies.

Notwithstanding this fact, section 7(g) does not require the result advocated by Alcoa and Vanalco. Section 7(g) states in pertinent part:

[T]he Administrator shall equitably allocate to power rates, in accordance with generally accepted ratemaking principles and the provisions of this chapter, all costs and benefits not otherwise allocated under this section, including, but not limited to, conservation, fish and wildlife measures, uncontrollable events, reserves, the excess costs of experimental resources acquired under section 839d of this title, the cost of credits granted pursuant to section 839d of this title, operating services, and the sale of or inability to sell excess electric power.

16 U.S.C. §839e(g).

Section 7(g) addresses the allocation of costs not otherwise allocated by the rate directives “to power rates.” In other words, section 7(g) costs are allocated across all power rates, including non-DSI power rates. Section 7(g) does not address the allocation, equitable or otherwise, of rates within a customer class. Therefore, Alcoa and Vanalco’s suggestion that section 7(g) requires that the “costs and benefits” of the 1,440 aMW must be equitably or uniformly allocated between the DSIs is misplaced. Alcoa and Vanalco state in their brief on exceptions that this analysis is insufficient. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 76. However, because section 7(g) does not address intra-class allocations of power costs not otherwise allocated under the rate directives, it simply has no application to the issue. That fact alone would appear to provide a sufficient explanation. The consequence of adopting the proposal of Alcoa and Vanalco and allocating the costs of the 450 aMW market purchase equally between the DSIs would be to confer on Alcoa and Vanalco the benefits of the Compromise Approach agreement without those companies being required to meet the obligations under that agreement.

If Alcoa and Vanalco are arguing that section 7(g) requires that the entire 1,440 aMW be allocated across all power rates because the IPTAC rates are not being priced in total under

section 7(c)(2), this is also incorrect. BPA acknowledges that the direct assignment of purchase power costs to a particular customer class is unique. Berwager *et al.*, WP-02-E-BPA-38, at 12. However, the direct assignment to the DSIs of the costs associated with the purchase of the additional 450 aMW is justified in light of the novel facts and circumstances under which BPA's DSI service proposal is being made. *Id.*

One novel fact, as noted, is that the Administrator is not obligated to make any section 5(d) sales to the DSIs after September 30, 2001. Likewise, the decision to purchase 450 aMW to serve DSI load is also a discretionary. BPA's objective in making these sales is to enhance DSI smelter survivability, but without raising other customers' rates; the extent of BPA's ability to roll into all customers' rates the cost of augmenting purchases to meet DSI load and still satisfy these competing principles is 990 aMW. *Id.* However, BPA's goal of enhancing the prospects of DSI survivability is best achieved through a proposal that offers more power than would be available at the cost-based rate (990 aMW) by making this additional market based purchase of 450 aMW. *Id.* at 11-12. The best way to reconcile the competing goals of enhancing survivability with no additional cost to other customers is to allocate the full cost of the 450 aMW to the DSIs, which every DSI other than Alcoa and Vanalco agreed to as part of the Compromise Approach agreement. Simply put, if BPA were compelled by section 7(g) to allocate the costs to all power rates of these discretionary purchases made in support of a discretionary sale--which it is not--it would likely not make any service proposal for the DSIs. As explained elsewhere, to do so would frustrate BPA's policy goal of enhanced smelter survivability without rate increases to other customers. Section 7(g) contemplates the equitable allocation of costs not otherwise allocated by the rate directives to the power rates of *all* customer classes, but the costs of this power are not properly allocable to other customers in the context of this proposal.

Finally, Alcoa and Vanalco argue that BPA's proposal to charge them a higher rate than other DSIs violates section 205(b) of the Federal Power Act (FPA), 16 U.S.C. §824d(b), and some cases interpreting that provision. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 14-16. Of course, section 205(b) of the FPA, which prohibits undue preference or advantage or undue prejudice or disadvantage in rates, applies only to "public utilities," and so is not applicable to BPA. Likewise, the cases cited by Alcoa and Vanalco establishing criteria for when different rates applicable to otherwise similarly situated customers are justified are not applicable to BPA ratemaking.

Some provisions in BPA's organic statutes do expressly forbid discrimination by the Administrator. For example, section 6 of the Transmission System Act requires the Administrator to make transmission capacity in excess of BPA's requirements available to all utilities on a fair and nondiscriminatory basis. 16 U.S.C. §838d. No such provision exists with respect to the formulation of rates for discretionary sales of power by the Administrator to the DSIs, and the courts will not apply such a standard where Congress has not made one expressly applicable. In *Southern California Edison v. Jura*, 909 F.2d 339 (9th Cir. 1990), the court refused to apply a nondiscrimination standard to BPA's extraregional nonfirm energy rates where Congress did not expressly provide one for such rates, but had "expressly prohibited discrimination or 'undue' discrimination in other very similar administrative contexts," including section 205(b) of the Federal Power Act. *Id.* at 343. Similarly, in *Aluminum Co. of America v. Bonneville Power Admin.*, 903 F.2d 585 (9th Cir. 1989), in discussing the applicability of

section 825s of the Flood Control Act to the establishment of extraregional nonfirm rates, the court held that “no ‘fair and reasonable’ standard is applicable to BPA ratemaking.” *Id.* at 591.

Even if such a standard did apply in this case, BPA has articulated a strong factual rationale for the higher rate it proposed to charge Alcoa and Vanalco. Charging these two companies a slightly higher rate is consistent with the negotiated nature of these sales and the context of the Compromise Approach agreement. Requiring the Administrator to offer Alcoa and Vanalco the same rate paid by DSIs willing to offer the Administrator valuable consideration in return would seriously undermine the Administrator’s ability to operate BPA in a business-like manner. Alcoa and Vanalco argue that the most important fact arguing against BPA’s proposal is that BPA is not a private utility, but a government agency that is both the rate applicant and the decisionmaker. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 16. However, Congress endowed the Administrator “with broad-based powers to act in accordance with BPA’s best business interests--powers not normally afforded government agencies.” *Association of Public Agency Customers v. Bonneville Power Admin.*, 126 F.3d 1158, 1170 (9th Cir. 1997).

Of course, any defect to the rates proposed for Alcoa or Vanalco may be cured by simply not offering a new power sales contract to these two companies. Although BPA’s proposal for service to the DSIs contemplates service to both Alcoa and Vanalco, the actual decision whether to offer a power sales contract based on the service proposal ultimately adopted by the Administrator in the rate case is not itself a rate case issue.

Decision

The decision to charge Alcoa and Vanalco a slightly higher rate than the DSIs that signed the Compromise Approach is justified by strong business and policy considerations and is not otherwise prohibited by law.

Issue 2

Whether the method used to calculate the industrial IPTAC rates is inconsistent with section 7(c)(2) of the Northwest Power Act.

Parties’ Positions

Alcoa and Vanalco argue that the Northwest Power Act mandates that firm power sales to the DSIs be at the IP-02 rate as calculated by section 7(c)(2) of the Northwest Power Act, and that the proposed IPTAC rates are inconsistent with that provision. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 72-75. They note that of the proposed DSI service amount of 1,440 aMW, 990 aMW will be priced using a cost-based approach consistent with the IP-PF relationship of section 7(c)(2), but that the remaining 450 aMW will be melded in at a price that reflects the market price. *Id.* at 72. They argue that this runs afoul of section 7(c)(2) because it uses the IP-02 rate established by that provision as only one element of the IPTAC rates. *Id.*

Alcoa and Vanalco cite section 5(e)(1) of the Northwest Power Act for the proposition that there are only four classes of regional customers for firm power, and BPA’s proposal for two IPTAC

rates effectively creates a fifth class, in violation of both section 5(e)(1) and section 7(c)(2). *Id.* at 72-73. They argue that the proposal to link the 450 aMW of market-priced power with the 990 aMW of section 7(c)(2) priced power imposes an “improper tying arrangement,” and that tying the DSIs’ ability to purchase the 990 aMW with an obligation to purchase the 450 aMW of market-priced power is not authorized anywhere in the Northwest Power Act and is not justified, since BPA has sufficient amounts of critical water power to serve all regional firm load. *Id.* at 74.

Alcoa and Vanalco state that section 7(c) defines the revenues to be collected from the DSIs, and such revenues are not based on the resources serving these loads but are based on the PF rate plus a margin. *Id.* at 75. They argue that the cost of the resources used to serve them must be allocated to the “section 7(b) rate pool” and then priced under section 7(c)(2). *Id.* Alcoa and Vanalco conclude that the proposed IPTAC rates fail this legal standard because, by directly assigning to the DSIs the purchase costs of the 450 aMW, the IPTAC rate overrecovers the revenues lawfully allowed by section 7(c)(2), and that the IPTAC rates unlawfully combine a section 7(c) sale and a section 7(f) sale. *Id.*

Alcoa and Vanalco repeat most of these arguments in their brief on exceptions. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 80-86.

BPA’s Position

BPA’s proposal is to offer the DSIs 1,440 aMW, but to price only 990 aMW (approximately 69 percent) of this amount at the cost-based section 7(c)(2) rate. The projected purchase power costs of the remaining 450 aMW would be allocated directly to the DSIs. BPA’s proposal is to combine the two components (990 aMW priced at 20.98 mills/kWh and 450 aMW priced at 28.1 mills/kWh) to create the IPTAC rates (23.5 and 25 mills/kWh) applicable to the sale of the 1,440 aMW. Nothing in the Northwest Power Act prohibits the Administrator from allocating directly to the DSIs the purchase power costs made to support a discretionary sale to those customers. Because the proposed sale is discretionary, the Administrator may allocate as much or as little of the costs of that discretionary purchase and sale to the section “7(b) rate pool” as she determines is appropriate and consistent with BPA’s other ratesetting goals. In this case, the Administrator proposed to allocate to that pool 990 aMW of the 1,440 aMW needed to support sales to the DSIs, because that is the amount that can be allocated to the rates paid, in part, by other customers without triggering a rate increase over current levels. This 990 aMW is then priced pursuant to section 7(c)(2) for sale to the DSIs.

However, the Administrator has elected to propose serving an additional 450 aMW (for a total of 1,440 aMW) of DSI load at below market rates in response to the concern that, absent the availability of a substantial amount of low-cost Federal power, a significant number of family-wage aluminum smelter jobs in the region will be at risk. Berwager *et al.*, WP-02-E-BPA-09, at 6. BPA’s proposal is to allocate the costs of this 450 aMW directly to the DSIs. *Id.* at 8-9. Nothing in the Northwest Power Act requires that the additional 450 aMW be allocated to the section 7(b) rate pool and priced under section 7(c)(2).

BPA's ability to achieve the goals of enhancing the prospects of DSI smelter survivability and associated jobs, while not simultaneously raising other customers' rates, is best achieved through the proposal to offer more power than would be available to the DSIs at the cost-based 7(c)(2) rate (990 aMW). Berwager *et al.*, WP-02-E-BPA-38, at 9. This is accomplished by making additional market-based purchases (450 aMW), allocating the costs directly to the DSIs, and melding the costs of the two components together, creating the IPTAC rates. *Id.* at 10. Another benefit that BPA receives from blending the two amounts of power into a single amount offer is that the entire amount will be subject to the power CRAC, which provides BPA and its other customers a higher level of risk protection than would be the case if the amount was limited to 990 aMW. *Id.* at 12.

Evaluation of Positions

Alcoa and Vanalco argue that all firm power sales by BPA to the DSIs must be priced under section 7(c)(2) of the Northwest Power Act. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 75. Whether BPA is obligated to price all firm power sales to the DSIs under section 7(c)(2) must be examined in the context of three important circumstances surrounding BPA's DSI service and rate proposal: (1) the Administrator has no obligation to offer a new section 5(d) power sales contract to the DSIs for the period after September 30, 2001; (2) the Administrator is exercising her discretion to make such sales in order to enhance the prospects of DSI smelter survivability, and the jobs associated with those operations, through the next rate period; and (3) a limitation on the proposal was that it not require rate increases for BPA's other customers. The argument by Alcoa and Vanalco that BPA must price the entire 1,440 aMW amount at the section 7(c)(2) rate is neither required by the statutes nor consistent with the discretionary nature of the proposal or the goals that have shaped it.

Given the third element of the Administrator's proposal (no rate increases for other customers), if BPA were in fact required to include the costs of the 450 aMW of augmenting power purchases in the section 7(b) rate pool and price that power under section 7(c)(2), the Administrator simply would not exercise her discretion to make that power available in the first instance. However, given the second element of the proposal (enhancing smelter survivability), the total amount of service (1,440 aMW) is important. Allocating only 990 aMW to the DSIs would represent substantially less than half of each DSI's potential load in the region. Berwager *et al.*, WP-02-E-BPA-09, at 9. This smaller amount might encourage the use of reduced production schedules to manage energy costs, and would be inconsistent with BPA's focus on helping to maintain as many DSI jobs in the region as possible consistent with BPA's other marketing and ratemaking goals. *Id.* Adding the 450 aMW and allocating the costs of the power directly to the DSIs, then melding those purchases with the 990 aMW priced under section 7(c)(2), materially aids smelter survivability by encouraging the broad use of these benefits over a larger DSI load than would be the case if the amount were only the cost-based portion. Berwager *et al.*, WP-02-E-BPA-38, at 9.

Section 7(c)(2) has two principal requirements: (1) that rates for the DSIs be established at a level which the Administrator determines to be equitable in relation to the retail rates charged by public body and cooperative customers to their industrial customers in the region, 16 U.S.C. §839e(c)(1)(B); and (2) that such rates in no event be less than the rates in effect for

the contract year ending June 30, 1985 (the floor rate), 16 U.S.C. §839e(c)(2). BPA is not taking the position that just because section 5(d) sales to the DSIs after September 30, 2001, are discretionary, that section 7(c)(2) is not applicable to such sales. In particular it is important that, on average measured across the rate period, the proposed DSI rate recover revenues that are equal to or greater than revenues under the section 7(c)(2) floor rate. This element of the test is clearly met in this case, because the proposed floor rate is 20.98 mills/kWh, lower than the proposed IPTAC rates. *See supra*, at 15.2.3. With respect to the equitable rate requirement, BPA proposed to allocate the maximum amount it can to the section 7(b) rate pool (990 aMW), and price such power at the “equitable” section 7(c)(2) rate, and still maintain its other ratemaking goals, primarily its goal to not increase the rates of its other customers. Berwager *et al.*, WP-02-E-BPA-38, at 12. However, absent allocating another 450 aMW to the DSIs, BPA’s survivability goals are frustrated, but allocating the costs of that power to the 7(b) rate pool is not possible without increasing other customers’ rates. *Id.* The result is that if BPA were required to allocate the 450 aMW to the 7(b) pool and price that power under section 7(c)(2), the Administrator would effectively be placed in the position of making no proposal for serving DSI load. In the context of discretionary post-2001 sales, it is not reasonable to read section 7(c)(2) to require such a result.

Alcoa and Vanalco cite section 5(e)(1) (16 U.S.C. §839c(e)(1)) for the proposition that Congress contemplated only four rate classes, and that the proposal to have two IPTAC rates divides the DSI class into two distinct classes of customers, resulting in five rate classes, which is not authorized under section 7(c)(2) of the Northwest Power Act. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 72-73. However, section 5(e)(1) is not relevant to the question whether BPA may have different rates for members of the same class of customers, or whether the Northwest Power Act contemplates a single DSI rate calculated pursuant to section 7(c)(2). Section 5(e)(1) establishes certain parameters around the Administrator’s right to restrict the contractual entitlement of customers to firm power. The provision creates the four categories of customers expressly and exclusively “[f]or purposes of this paragraph” implementing the restriction provisions, not for any ratemaking purpose. Alcoa and Vanalco argue that this logic is unresponsive to their argument. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 83. However, if the argument by these parties is that section 5(e)(1) creates exclusive and immutable rate classes for purposes of power ratemaking, then BPA’s response that the provision has no application to ratemaking issues seems completely responsive. In any case, section 5(e)(1) addresses the contractual entitlement to firm power, which neither Alcoa or Vanalco will have after September 30, 2001, absent a new contract offer from the Administrator.

Alcoa and Vanalco argue that the proposal to link the 450 aMW of market-priced power with the 990 aMW of cost-based priced power constitutes an “improper tying arrangement” that is not authorized by the Northwest Power Act and is not necessary, because BPA has sufficient inventory to serve all regional firm load without such a proposal. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 73. First, BPA does not have sufficient inventory to serve Alcoa and Vanalco absent purchases to augment its inventory. Alcoa and Vanalco were able to argue there is sufficient inventory because they selectively exclude certain resources and load obligations in their determination that BPA has surplus energy. Rather than including all of BPA’s loads and resources, Alcoa and Vanalco have hand picked certain loads and resources for inclusion and selectively ignored other loads and resources in the Loads and Resource Study. This manner of

calculating the load/resource balance allows them to draw the conclusion that BPA has sufficient inventory. Had Alcoa and Vanalco included all of BPA's loads and resources, they would have found that on a fiscal year basis BPA is 38 MW deficit on a five-year average basis, and that on an operating year basis BPA is in load/resource balance. *See, generally*, Loads and Resources Study, WP-02-E-BPA-01; *see also*, Tr. 867-868.

Second, as explained above, the 450 aMW component of the Administrator's proposal, and its rate treatment, is critical to meeting the goal of enhanced survivability without rate increases. This is a discretionary allocation of power designed to meet these goals, and nothing in the Northwest Power Act prohibits the Administrator from exercising her discretion in the manner proposed. Nevertheless, BPA is taking on the risk that the expected costs of the 450 aMW will in fact be recovered. Berwager *et al.*, WP-02-E-BPA-38, at 13. There is some risk that the cost of obtaining this power will be higher than forecast in the rate case, if BPA waits to purchase until the sales amount is known, or that the loads will not materialize once BPA has purchased the power, if it locks in the purchases before the sales amount is known. *Id.* Therefore, the implication that BPA is somehow financially benefiting from tying the market-based component to the cost-based component of the proposal is wrong. Alcoa and Vanalco also argue that the 450 aMW component of the proposed sale will be made more expensive for the DSIs because BPA's presence in the market will drive up prices. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 80-81. However, the rate for the 450 aMW market purchase component of this sale is being established at 28.1 mills/kWh, so BPA is taking the risk the price will be higher, not the DSIs.

Alcoa and Vanalco also argue that the proposed IPTAC rates unlawfully combine a section 7(c) and a section 7(f) sale. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 75. They cite excerpts from a past BPA ROD for the proposition that Congress did not intend BPA's DSI customers to pay for their direct service from BPA at a rate other than the section 7(c) rate. *Id.* However, the statements in the cited material were made in the context of mandatory direct sales to the DSIs under the mandatory section 5(d)(1)(B) initial long-term contracts. Again, the treatment of the 450 aMW is consistent with the discretionary nature of this proposal and is necessary to achieve the goals that underlie the proposal.

In the same context, Alcoa and Vanalco argue that the proposed IPTAC rates may not be justified simply as a matter of rate form allowed by section 7(e) of the Northwest Power Act (16 U.S.C. §839e(e)), because the proposal to assign to the DSIs the purchase cost of the 450 aMW means the IPTAC rates overrecover the revenues lawfully allowed by section 7(c)(2). Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 75. Section 7(e) provides that:

Nothing in this chapter prohibits the Administrator from establishing, in rate schedules of general application, a uniform rate or rates for sale of peaking capacity or from establishing time-of-day, seasonal rates, or other rate forms.

16 U.S.C. §839e(e).

Section 7(f) provides that:

Rates for all other firm power sold by the Administrator for use in the PNW shall be based upon the cost of the portions of Federal base system resources, purchases of power under section 839c(c) of this title and additional resources which, in the determination of the Administrator, are applicable to such sales.

16 U.S.C. §839e(f).

The IPTAC rates reflect BPA's proposal for a discretionary sale that provides the DSIs with a large quantity of below-market power, addressing the smelter survivability issue without raising other customers' rates. However, such a proposal, balancing these competing service and ratemaking goals, would not be possible if priced in total under section 7(c)(2), although the great majority of the power under this proposal (approximately 69 percent) is priced under section 7(c)(2). As already explained, the Administrator is not limited in this context to allocating to the 7(b) rate pool all the resources needed to serve the DSIs and pricing sales of those resources at the 7(c)(2) rate. In fact, she has elected to price 450 aMW of the proposed sale under section 7(f). So the argument of Alcoa and Vanalco that the IPTAC rates recover more than permissible under section 7(c)(2) is incorrect. The pool of resource costs appropriately allocated to the DSIs includes both the cost-based 990 aMW (section 7(c)(2) rate) and the market-priced 450 aMW (section 7(f) rate). Under this framework, section 7(e) provides an appropriate vehicle for the proposed IPTAC rates, which are designed to recover the costs of those resources.

Decision

In the context of this discretionary section 5(d) sale, the Administrator is not obligated to allocate all resources needed to support such sales to the section 7(b) rate pool and price such sales exclusively under section 7(c)(2). The IPTAC rates are not inconsistent with section 7(c)(2).

15.5.5 Allocation Methodology

Issue

Whether BPA should allocate power to the DSIs based on plant capacity.

Parties' Positions

Alcoa and Vanalco argue that BPA's proposal to allocate power to the DSIs based on the level of power purchases during the last 5-year period of the 20-year 1981 contract is a breach of that contract and a "1996 accord and satisfaction." Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 76. They propose that the allocation be based on plant capacity. *Id.*

They argue that BPA "may not use its supposed exercise of discretion" in the selection of how to apportion the DSIs' power sales to punish Vanalco and Alcoa for exercising their rights under

the 1981 contract. *Id.* at 78. They assert that BPA's proposal will force them to go to market for a substantial portion of their power needs, thereby substantially increasing the likelihood of Alcoa and/or Vanalco being forced to close smelters during the rate period, and that this is inconsistent with BPA's goal of offering a combination of power and rates to "ensure DSI survivability as a class." *Id.* at 79.

BPA's Position

BPA's proposal is to allocate available power to the DSIs according to the relative amounts of IP-96 power purchased by each DSI in the current rate period. Berwager *et al.*, WP-02-E-BPA-09, at 7. DSIs that purchased larger amounts of IP-96 power from BPA during this period will be entitled to a larger proportional share of the available power than DSIs that placed less IP-96 load on BPA. *Id.*

The primary benefit BPA received from the DSIs that purchased under the IP-96 rate during the current rate period was a high degree of certainty that BPA would be able to cover its costs. Berwager *et al.*, WP-02-E-BPA-38, at 11. Some purchased more than others, even though they could have obtained better prices in the short-term market, and the general consensus at the time was that BPA's proposed IP-96 rate would be above market through the rate period, and this created a benefit for BPA. *Id.*; Berwager *et al.*, WP-02-E-BPA-09, at 8. It is entirely appropriate to reflect this benefit in how BPA will allocate available power when it enters into discretionary post-2001 sales to the DSIs. Berwager *et al.*, WP-02-E-BPA-38, at 11.

Evaluation of Positions

Alcoa and Vanalco provide a summary of events that led to the negotiation of the "Block Sale Contracts" with the DSIs in 1996, and to BPA's offer of long-term transmission contracts allowing the DSIs to make non-Federal power purchases, which together appear to constitute the "accord and satisfaction" they reference. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 77-78. They note that most DSIs decided to sign a Block Contract, but that Alcoa and Vanalco elected to stay with their 1981 contracts and exercise their right to reduce their purchases from BPA under that contract. *Id.* at 78. Alcoa and Vanalco conclude that BPA's allocation proposal "is a breach of the covenant of good faith and fair dealing" because it deprives Vanalco and Alcoa of their benefits under the 1981 contract and the 1996 accord and satisfaction. *Id.* at 78.

BPA's allocation proposal in no way deprives Alcoa or Vanalco of any benefit or right under the 1981 contract. If they believe BPA has somehow breached that contract, or some duty of good faith and fair dealing, they are free to pursue those claims in the appropriate forums. Alcoa and Vanalco assert that BPA is punishing them through its allocation proposal for exercising their rights under the 1981 contract to reduce load on BPA. *Id.* However, given BPA's limited ability to provide the DSIs with an amount of power at below market prices, it is fair and reasonable to allocate that limited resource based on each DSI's commitment in 1995 to provide revenue certainty to BPA during the current rate period, enhancing BPA's continuing ability to bring long-term benefits to the region. Berwager *et al.*, WP-02-E-BPA-38, at 11; Berwager *et al.*, WP-02-E-BPA-09, at 8. At least one DSI customer indicated it would support the Compromise Approach agreement only if BPA allocated available power pursuant to this methodology.

See Cross-Examination Exhibit, WP-02-E-AL-32, at 3 (“Reynolds [Metals Company] supports the proposed amount of power for service to the DSIs, provided the power is allocated among the DSIs in the manner proposed by BPA.”)

Nevertheless, Alcoa and Vanalco argue that BPA has provided no rationale for why the last five years of the 1981 contracts should receive 100 percent weighting and the first 15 years no consideration. Alcoa/Vanalco Ex. Brief, WP-02-R-AL/VN-01, at 87. To the contrary, while BPA has articulated its rationale for allocating a scarce benefit based on the level of IP-96 purchases placed on BPA by each DSI, Alcoa and Vanalco have failed to propose any reasonable alternative. Alcoa and Vanalco urge BPA to simply forget the level of past purchases by any company over any period, but to allocate available power based on each company’s total plant load as a percentage of total sales to the DSIs. See Speer *et al.*, WP-02-E-AL/VN/EG-01, at 15-17. This proposal is not supported by any rationale other than an argument that to do otherwise somehow violates their 1981 power sales contract rights and expectations, and that the DSIs that signed Block Sale Contracts were rewarded with stranded cost protections, and that rewarding them now with greater allocations is not appropriate. *Id.* at 12-15. Whether this is true or not, Alcoa and Vanalco continue to refuse to recognize the critical importance BPA placed in 1996 on retaining as much DSI load as possible at the IP-96 rate. Given the limited resource BPA can allocate to the DSIs at this time, it is not only reasonable but fair to allocate that limited resource recognizing the commitment made by each company to BPA at that time through the Block Sale Contracts.

In addition, their argument is irrelevant because whether the allocation methodology is “fair” is not a legal standard that applies to this decision. The Administrator has no obligation to offer either Alcoa or Vanalco a new section 5(d) contract for the post-2001 period. See *supra*, at 15.5.3. Even if she did, nothing in the Northwest Power Act, or any other BPA enabling statute, indicates that BPA would be required to meet each DSI’s full requirements. Alcoa and Vanalco disagree, and suggest that each DSI’s plant capacity is the appropriate allocator, citing the 1981 and 1996 contracts as support. Alcoa/Vanalco Brief, WP-02-B-AL/VN-01, at 78. Of course, the amount of power allocated to each DSI in its 1981 contract was fixed by section 5(d)(1)(B) of the Northwest Power Act to be equivalent to the amount of power each DSI was entitled to under its 1975 contract with BPA. These 1981 contracts were the mandatory initial long-term contracts that BPA was obligated to offer each DSI. However, allocations under section 5(d)(1)(A) are not dictated by section 5(d)(1)(B), which applied only to those initial contracts. Given that, a decision would still be required of the Administrator allocating whatever amount of power she could provide the DSIs consistent with BPA’s other policy and ratemaking objectives and obligations. In effect, there is no law to apply to the allocation decision, because no provision in BPA’s statutes limits the Administrator’s discretion respecting allocations of post-2001 power to the DSIs under section 5(d)(1)(A). Cf. *City of Santa Clara v. Andrus*, 572 F.2d 660 (9th Cir. 1978) (recognizing unfettered discretion in Secretary of Interior regarding allocation of Federal power to public preference customers absent specific statutory limitation on such discretion). In any case, as explained above, BPA believes its proposed allocation methodology is fair.

Finally, Alcoa and Vanalco assert that BPA’s proposed allocation methodology is inconsistent with its stated goal to “ensure DSI survivability as a class.” Alcoa/Vanalco Brief,

WP-02-B-AL/VN-01, at 79. They argue that because they are being forced to go to the market for a substantial portion of their power needs (for Vanalco the amount is 97.5 percent) there is a substantially higher likelihood of Alcoa and/or Vanalco being forced to close its smelters during the rate period. *Id.* Alcoa and Vanalco have mischaracterized the nature of BPA's goals regarding DSI smelter survivability. BPA cannot guarantee the survivability of either any individual DSI or the DSIs as a class, and BPA never stated that was its goal. Berwager *et al.*, WP-02-E-BPA-09, at 10. BPA's interest is in doing as much as it can to preserve DSI smelter jobs consistent with its other strategic goals and commitments. *Id.* at 11. BPA has a limited ability at this time to provide the DSIs with power at below-market rates. As a consequence, the Administrator is forced to make choices regarding how to allocate that limited resource among the members of the DSI class of customers.

The allocation methodology proposed by the Administrator attempts to balance the objective of offering some Federal power at below-market rates to each DSI, while recognizing the level of commitment made by each DSI in 1996 both to BPA's transition into the deregulated energy market and BPA's continuing ability to bring long-term benefits to the region. *Id.* at 8. Under BPA's proposed allocation methodology, Alcoa and Vanalco would receive a total of 230 aMW of below-market priced power, or roughly 16 percent of the total available to the DSIs, notwithstanding the fact that both Alcoa and Vanalco placed very little load on BPA in 1996 at the IP-96 rate. *Id.*

Decision

BPA is not required by the 1981 contracts, the so-called 1996 accord and satisfaction, or BPA's enabling statutes to allocate power to the DSIs based on plant capacity. BPA will use the allocation methodology based on each DSI's average annual purchases in the current rate period at the IP-96 rate.